Commission to Review Massachusetts Anti-Takeover Laws

Interim Report

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DISCUSSION OUTLINE

I. Why are we concerned with this issue?

A. "Social costs"

1. Job loss/dislocation from plant closings or layoffs caused by hostile takeovers and subsequent restructurings and/or restructurings undertaken as a takeover defense or after a successful takeover defense.

   a) Evidence mixed. Little data available to conclusively demonstrate that on average hostile takeovers and/or takeover-related restructurings cause greater dislocations than would occur otherwise through economic transition. Some evidence suggests that a distinction can be made between "financial takeovers" done exclusively for short-term profit and "industrial" takeovers done as part of a business building strategy.

   b) Some evidence suggests that takeovers may be one of the few ways companies can effectively restructure.

   Query: Are closings/layoffs caused by hostile takeovers or takeover related restructurings qualitatively different from other closings/layoffs so that affected interests warrant special treatment?

2. Community impact

   a) Direct effect of any job losses caused by restructuring

   b) Ripple effect of any job losses caused by restructuring

   c) Loss of charitable contributions and leadership offered by company.

   Query: It is clear that the immediate impact is negative and highly visible for those takeovers or takeover attempts that result in "bust-ups" or substantial restructuring. However, the problem is analogous to that with the dislocated worker; are the effects of hostile takeovers and/or takeover-related restructurings qualitatively different from the effects of other closings/layoffs?

3. Suppliers

   a) Disruption of long-term supplier relationships (implicit contracts) with clear direct and ripple effects on suppliers and potential for creating disincentives to re-establishing similar relationships in the future.

4. Creditors

   a) Direct effect on creditors who have made loans on the assumption that there will be a long-term relationship with existing management.

5. Regional Economy

   a) There may be a special public concern in the takeover context for communities/regions that are highly dependent on one company or on an industry. Is the better response through incentives/assistance for diversification or regulations of takeovers on geographical or sectoral basis

B. Competitiveness - long-term economic impact

1. Basic assumptions of what's required for long-term competitiveness:

   a) Long-term investments in R&D, product and process development/commercialization, physical plant and equipment, human resource development

   b) Availability and mobility of "patient" capital to make the above investments

   c) Reallocation of resources from unproductive to productive uses (structural economic change; creative destruction)

   d) Aggressive, entrepreneurial management

   e) Highly skilled, adaptable and motivated workforce

2. Issues raised by takeovers

   a) Short-term/long-term

      (1) Threat of takeovers creates disincentives to making long-term investments in R&D, product development and commercialization, physical plant and equipment, human resource development which can depress stock prices and make a firm a more attractive target.

      (2) Focus turns from maximizing long-term profit to developing best short-term strategies to prevent takeover.

   b) Takeovers and productivity/efficiency

      (1) Strongest argument for takeovers is that they are in many cases the only effective mechanism for removing "poor" management that has not adapted to changes in the marketplace. Adaptation may or may not require closure of a facility.

(2) Studies mixed on the extent to which takeovers actually result in better performance. Key variables are timeframe used and whether stock price or other criteria are used to measure performance.

(a) Stock price studies suggest targets perform better after takeovers, evidence stronger the shorter the timeframe used. Such studies are criticized on the basis that the assumption that stock prices accurately reflect corporate value, particularly where long-term investments are involved, is invalid.

(b) Studies using other measures suggest takeovers have a negative or at best neutral effect on target performance in the long-run. The key variables appear to be the interest of new management in "growing" a business rather than in "making a fast buck" and the presence of synergies created between raider and target.

(c) There is no question that in individual cases takeovers have had a positive effect by removing incompetent management, just as there are well documented horror stories.

(d) What is perhaps more important, takeovers affect all firms by creating an environment changing management behavior to respond to market forces that appear to require strategies that ensure stock prices remain high to keep raiders away.

c) Availability/mobility of capital depends on two major factors: 1) investors getting a return; and 2) investor confidence in financial markets

(1) Shareholder interest

(a) Clear short-term benefit through 30-50% takeover premiums.

(b) Unless takeovers create real wealth by increasing productivity or reallocating capital to more productive uses, the long-term benefit is unclear; particularly troubling for institutional investors who must invest in securities.

(c) Abuses and excesses such as 2-tiered tender offers, street sweeps and greenmail raise shareholder equity problems that may undermine confidence in financial markets.

(d) Highly speculative markets tend to scare individual investors leading to expanding role of institutional investors and arbitrageurs with less incentive to provide "patient" capital.

(2) Transaction costs

(a) Industries have developed to "do deals" diverting funds away from "growing businesses" to "doing takeovers." Two effects: if takeovers do not produce social wealth this is a source of waste; a vested interest is created in the dealmakers to continue the activity whether productive or not.

(b) As non-target firms adopt the strategies of targets, these transaction costs are not just limited to the relatively small number of target firms.

(c) General diversion of management expertise and attention away from maximizing long-term profits.

(3) Leveraging and stability of corporations

(a) Debt/equity ratio

(b) Concerns over impact of downturn of next business cycle

(c) Need to service debt requires more conservative business strategies to ensure sufficient liquidity

(d) Junk bonds and associated concerns relating to the use of below investment grade bonds to finance takeovers, LBOs or defensive restructurings, particularly as the overall level of corporate debt increases

(e) General perception that American corporations are over-leveraged and its impact on access to foreign capital

II. What are the trends?

III. What responses have been made at the federal level?

A. Williams Act (1968) with emphasis on shareholder protection through disclosure and maintaining "level playing field" between buyers and targets.

B. Edgar v. MITE

C. CTS v. General Dynamics of America

D. H.R. 2172 (Dingell/Markey)

E. S. 1323 (Proxmire/Riegle)

F. SEC regulatory actions

G. Federal Reserve decision re junk bonds

IV. What responses at the state level?

A. "First generation" laws

B. "Second generation" laws

1. Indiana/Massachusetts - control share acquisition model with subsequent transfer of shares subject to shareholder approval.

2. Ohio - control share acquisition model with actual transfer of share subject to prior shareholder approval rather than the subsequent transfer of voting rights.

3. New York - asset freeze model

4. Delaware - business combination model - asset chill

5. Minnesota - modification of corporate directors' fiduciary duty to include consideration of the interests of stakeholders as well as shareholders.

V. What options are available to further regulate takeovers?

A. State level

B. Federal level

[Please see attached matrix]

VI. Recommendations

ISSUES	PREVENTATIVES	TRANSACTION REGULATION	EFFECTS & CONSEQUENCES
Disclosure	STATE:		
	Community impact statement		
	Mini-Hart-Scott-Rodino		
	Mini Clayton s.7		
	FEDERAL:	FEDERAL:	
	Stronger anti-trust enforcement; cooperation with state efforts	Close 13D window	
		Tender offer reform	
	SEC enforcement of disclosure & insider trading provisions	Proxy reform	
Financing		FEDERAL:	STATE:
		Require raider to have financing in place before placing a corporation in "play"	Require successful raider to pay costs associated with worker dislocation including a re-employment assistance or health insurance paid
		Establish debt ceilings for certain types of transactions or financing mechanisms	Tin parachute and health benefit requirements
			Cost-sharing with existing state programs designed to facilitate transition - ISP/DES, MPDC, CAT & other quasi publics for suppliers

ISSUES	PREVENTATIVES	TRANSACTION REGULATION	EFFECTS & CONSEQUENCES
Shareholder Equity	STATE: Modifications to 156B to prohibit or limit use certain defenses absent shareholder vote, e.g. golden parachutes and poison pills	STATE: Modifications to 110C to increase informational requirements Ohio model - shareholder consent to transaction FEDERAL: Require cash tender offer where purchase exceeds X% of corporation See disclosure above	
Stakeholder Equity	STATE: Alternative charter - Scott Proposal Require state pension fund director to consider long-term impact of investments on both beneficiaries and the economy	STATE: Delaware model - asset chill New York model - asset freeze Minnesota model/S. 1502, H. 4451 - clarification of fiduciary duty of directors to include consideration of effect on stakeholders FEDERAL: Elminate preemption and one share one vote provisions from reform bills	STATE: Reich Proposal - greater protection for long-term commitments FEDERAL: Mandatory notice before plant closing or major layoff
Directors' Equity		STATE: Minnesota model/S. 1502, H. 4451 - clarification of fiduciary duty of directors	

ABUSE	PREVENTION	TRANSACTION REGULATION	CONSEQUENCES
Deception	STATE: Community Impact Statement Mini Hart-Scott-Rodino Mini Clayton 7 FEDERAL: Stronger anti-trust enforcement; federal cooperation with states SEC enforcement of disclosure & inside trading provisions	STATE: Modifications to 110C to increase informational requirements/ clarification of subpoena powers FEDERAL: Close 13D window Tender offer reform Proxy reform Require cash tender offer where purchase exceeds X% of corporation	FEDERAL: Mandatory notice before plant closing or major layoff
Coercion	STATE: Modifications to 156B to prohibit or limit use of certain defenses absent shareholder vote, e.g. poison pills, greenmail	STATE: Ohio model - shareholder consent to transaction Minnesota model/ S. 1502 H. 4451 - clarification of fiduciary duty of directors FEDERAL: Tender offer reform Proxy reform Require cash tender offer where purchase exceeds X% of corporation Eliminate preemption & one-share/one-vote provisions from House & Senate bills	

ABUSE	PREVENTION	TRANSACTION REGULATION	CONSEQUENCES
Stakeholders Employees Middle Mgt Suppliers Communities	STATE: Alternative charter - Scott Proposal Require state pension fund director to consider long-term impact of investments on both beneficiaries and the economy	STATE: Delaware model - asset chill (3 years) New York model - asset freeze (5 years) Minnesota model/ S. 1502, H. 4451 - clarification of fiduciary duty of directors to include consideration of effect on stakeholders	STATE: Reich proposal - greater protection for long-term commitments to stakeholders Require successful raider to pay costs associated with worker dislocation including re-employment assistance or health insurance paid by state or target Tin parachute and health benefit requirements Cost-sharing with existing state programs designed to facilitate transition - ISP/DES, MPDC, CAT & other quasi publics

ISSUES	PREVENTATIVES	TRANSACTION REGULATION	EFFECTS & CONSEQUENCES
Disclosure		STATE: M.G.L. c. 110C - "first generation" takeover law	
Financing			STATE: Mature Industries Act r quires employer to shar costs of continued grou health insurance covera in some instances
Shareholder Equity		STATE: M.G.L. c. 110C, D & E to the extent that their informational and time requirements permit shareholders to make more informed responses in the takeover context. M.G.L. c. 156B to extent it is narrowly interpreted to mean shareholder interests only	
Stakeholder Equity	STATE: Broad array of quasi-public financing agencies designed to provide both financial and technical assistance to firms for the purposes of new product and process development, retooling, R & D, and other long term investments designed to increase productivity and competitiveness, including: Mass Technology Development Corp; Mass Product Development Corp; Mass Industrial Finance Agency; Mass Centers of Excellence, particularly the Center for Applied Technology.	STATE: M.G.L. c. 156B standard for fiduciary duty of corporate directors to extent it is broadly interpreted to include consideration of stakeholder interests M.G.L. c. 110C, D & E to the extent that their informational and time requirements permit shareholders to make more informed responses in the takeover context.	STATE: Programs designed to facilitate economic tra sition and worker dislo cation including: Indus trial Services Program; Division of Employment Security; MassJobs; Mas Product Development Cor Center for Applied Tech nology & other financin and training agencies.

	Broad array of employment and training programs designed to provide options for retraining and skills upgrading for the workforce, including: the Bay State Skills Corp; Mass Technology Park Corp; the Industrial Services Program.		
Directors' Equity			

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M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani

DATE: August 8, 1988

RE: **DELAWARE BUSINESS COMBINATION LAW**

This memo is a response to requests at the last Commission meeting for a general overview of how the Delaware law works, its general effects and any empirical evidence relating to its operation. This request followed a discussion of the utility of a business combination-type statute in addition to the control share acquisition statute Massachusetts currently has in deterring coercive bids. The control share model was seen as valuable as a means of extending the time period the board of directors had to respond effectively to an unsolicited bid and for shareholders to obtain the information needed for them to vote their interests. The business combination model was seen as a potential supplement that could deter financial takeovers that often lead to the sale of target assets and associated worker and community dislocations. Any comments or criticisms of the following would be most welcome.

The business combination model is designed to encourage a bidder to negotiate with the board rather than make an unsolicited offer for control. It is also designed to encourage fully financed cash offers for a substantial majority, if not all, corporation shares. In essence, the two models are based on very different assumptions. The control share model assumes that given adequate time and information, a direct shareholder vote to approve/disapprove a control transaction best reflects their interests and the interests of the corporation and its stakeholders. By contrast, the business combination model assumes that the interests of the corporation, its shareholders and stakeholders are best served by its board which serves as the focus for negotiation on behalf of these disparate interests.

How the Delaware Business Combination Act works

Structurally, the Delaware Act is fairly simple. If a person acquires 15% or more of the voting stock of a Delaware corporation without prior board approval, he becomes an "interested stockholder" and may not engage in any "business combination" with the corporation for three years. A business combination is broadly defined to include mergers, sales of assets and transfers of stock.

Section 203 provides seven ways to avoid the business combination prohibition.

1. The board may approve the stock acquisition or the proposed business combination before the person becomes an "interested stockholder".

2. A person who acquires 85% of the voting stock in the transaction in which he becomes an "interested stockholder" is exempt from the statute. In calculating the 85%, shares owned by inside directors and ESOPs where employees lack confidential voting rights on those shares.

3. A proposed business combination may be approved by the board and 2/3 majority of the voting stock not owned by an "interested stockholder."

4. If the board approves a control transaction with a third party, any "interested stockholder" is free to propose and consummate a competing business combination within 20 days.

5. A person may conduct a proxy contest, replace the board and have the new board approve his stock acquisition or business combination in advance.

6. Stockholders may amend the bylaws to opt-out of Section 203. Such a by-law amendment will not become effective for 12 months after adoption and is inapplicable to a person who was an "interested stockholder" prior to its adoption.

7. An "interested stockholder" may acquire control of a company, remove the board and sell corporate assets to third parties or liquidate the corporation provided that any dividends or distributions are shared pro rata with the remaining stockholders.

General Effect

The Delaware Business Combination Act (Section 203) is not intended to prevent takeovers nor does it seem likely to accomplish this. Based on the debate surrounding its enactment, the Legislative intent appears to have been to protect shareholders from some of the more coercive aspects of hostile offers that became prevalent after cash-out mergers became possible with approval of a bare shareholder majority. (see attached) These include partial offers, two-tiered

offers and highly leveraged mergers using target assets as collateral. Each of these tactics forces shareholders to decide whether to tender their shares for a control premium up-front or run the risk of receiving a lower price at the back-end of the offer or losing the future value of those shares' through a "bust-up." Section 203 appears to address shareholder coercion indirectly by encouraging a potential acquiror to negotiate with the target's board and/or to make an offer that is attractive enough that 85% of the shareholders will tender. Like the poison pill upon which business combination-type statutes are modeled, the Delaware law is designed as a negotiating chip rather than a barrier. However, the real question is that given its significant differences from the New York statute (5-year freeze, <u>only</u> exception prior approval) whether the board of a Delaware corporation is given enough leverage to accomplish these ends.

The Delaware statute is designed, in part, to force a potential buyer to negotiate with the target board to obtain prior approval of a proposed business combination or of a purchase of shares that would make it an interested stockholder. In theory, the board is then in a position to reject an inadequate and coercive bid and negotiate a better deal, either with the original bidder or a third party. The board serves as the shareholders' representative permitting effective negotiation with what would otherwise be a highly decentralized and diverse group. Although there is considerable emphasis on negotiating on behalf of the shareholders, other corporate stakeholders are by no means excluded from consideration. A three year asset freeze could be an effective incentive to negotiate given that access to target assets is the key to obtaining most financing. In addition, even if financing were not an issue, a buyer might not be able to achieve the desired synergies and/or economies of scale without completing a second-step merger, undermining the most positive justification for a takeover, productivity increases. However, by placing decision-making with the board, Section 203 may also increase the fiduciary pressure on corporate directors from shareholders and, perhaps, the courts to accept a fully financed cash bid made at a market premium for all the corporation's shares. Consideration of legislation clarifying the fiduciary duties of corporate directors might be significant in this context.

The 85% control exception appears to be designed to encourage a potential buyer to set a price attractive enough to induce 85% of the shareholders to tender. The most obvious effects of this provision, if effective, is to increase the control premium and to limit the number of shareholders who could be "cashed-out" at a lower price in a second-step merger. This is probably as close as a state can come to significantly regulating coercive two-tiered tender offers without clearly violating the Supremacy clause and the federal courts have upheld Section 203 thus far. However, it is less clear that this provision will deter "bust-ups" as is sometimes assumed. At the margin, it would appear to discourage under-financed bids that rely heavily on target assets as collateral since such transaction would be less likely to be able to attract 85% of the outstanding shares and avoid the business combination prohibition. However, it could have

the perverse effect of encouraging a marginal bidder to increase his leverage to set an attractive price that would then require him to sell off assets in order to pay debt service. There does not appear to be any empirical evidence on this point due to the recent enactment of Section 203.

To the extent that the Delaware law empowers the board of directors to negotiate on behalf of the corporation, its shareholders and stakeholders, it would appear to improve the balance between bidder and target. In this sense, it acts much like a poison pill, by encouraging negotiation and providing the target board with additional time to respond to a bid and develop and pursue alternatives. It might also be expected to increase the overall bid price. But the statute will not, and is not designed to, prevent takeovers. It could effectively deter a "buyer" from putting a firm "in play" by buying 14% and negotiating with the board for a profitable settlement. However, it would seem less likely to prevent a "buyer" from putting a firm in play by buying 14% and then simply selling off at a profit if the stock goes up.

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MEMORANDUM

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS FOR BUSINESS COMBINATION LEGISLATION

GENERAL PROPOSAL:

Submit legislation based on a business combination model, with or without added provisions to supplement our current control share acquisition laws (M.G.L. c. 110D & 110E) specifically to deter two-step mergers and under-financed and/or over-leveraged takeovers which often prevent a segment of shareholders from realizing the full value of their investment in a corporation and which are most likely to lead to the sale of target assets and, therefore, in substantial dislocation of employees, communities and other stakeholders.

BACKGROUND:

On July 21, 1987 Governor Dukakis signed the Massachusetts Control Share Acquisition Act into law. This Act, M.G.L. c. 110D & 110E, like all control share acquisition (CSA) laws was designed to extend the time period for a corporation and its shareholders to respond to an unsolicited offer for control. By extending the response period, CSA laws are designed to address the coercive nature of such offers by permitting corporations to collect the information they need to evaluate such offers and to develop effective responses, whether in the form of other buyers or other strategies to remain independent. The Commission has discussed the effectiveness and/or value of the Massachusetts CSA law on an number of occasions and appears to feel that despite concerns that Chapters 110D and 110E could be used by an under-financed raider to put a firm in play, on balance, our CSA laws are valuable in providing the board of directors the time it needs to

evaluate an offer and respond effectively on behalf of the corporation, its shareholders and other stakeholders. However, there are other abuses associated with takeovers such as two-tiered tender offers and over-leveraged bust-ups, that have concerned the Commission that our CSA-type statutes are not designed to address. Proposals for a business combination type statute such as those in New York, New Jersey or Delaware have been made to address these concerns.

The basic business combination model is fairly simple. If a person acquires a threshold amount of the voting stock of a domestic corporation he becomes and "interested shareholder" and may not engage in any "business combination" with the corporation for a specified number of years. A business combination is broadly defined to include mergers, sales of assets and transfers of stock. By using the potential business combination prohibition and specific exemptions to that prohibition, these statutes are designed to encourage a bidder to negotiate with the board rather than make an unsolicited offer for control. In this sense, this type of statute is designed as a negotiating chip rather than as a barrier to the transaction itself. Business combination laws are also designed to encourage fully-financed cash offers for a substantial majority, if not all, outstanding shares. The two models are based on very different assumptions. The CSA model assumes that given adequate time and information, a direct shareholder vote to approve/disapprove the control share transaction best reflects shareholder interests and the interests of the corporation and its stakeholders. By contrast, the business combination model assumes that the interests of the corporation, its shareholders and stakeholders are best served by its board which serves as the focus for negotiation on behalf of these disparate interests. Despite this apparent inconsistency, at least 17 states have chosen to adopt both a control share acquisition and business combination law to address the coercion inherent in unsolicited offers as well as shareholder and stakeholder abuses associated with financial takeovers that often lead to the sale of target assets and worker/community dislocation.

As mentioned above, the major elements in business combination laws are: 1) the threshold trigger (1-15%); 2) the length of time the business combination prohibition extends for (3-5 years); 3) the availability of options for avoiding the business combination prohibition (2-7); and 4) the imposition of added conditions on buyer to exercise such options (Connecticut). Variations across these elements raise a number of generic concerns. Lowering the trigger threshold obviously expands application of the statute, increasing the probability that such a law may be viewed as an unconstitutional burden on interstate commerce but perhaps also decreasing the likelihood that a firm will be put into play for pure arbitrage purposes. Variation in length of the business combination prohibition raises similar concerns; longer prohibition diminishes the odds that a law will pass court scrutiny but also increases the disincentive to a

buyer of acquiring the firm on terms other than those deemed in the public interest, i.e., without triggering a statutory exception. Based on decisions concerning the Delaware law, the more "reasonable"* exceptions the law contains, the more likely it is to be upheld. The imposition of specific buyer conditions raises questions re equitable treatment of "hostile" v. incumbent management, at least in the Connecticut instance, apparently creating a double standard re responsible corporate conduct. Such a double standard could be easily removed through amendment of other state laws. However, absent such amendment, buyer condition provisions in a business combination law appear to reflect the assumption that incumbent management behaves more responsibly than "hostile" management would. A judgment call.

*In this context, "reasonable" is evaluated in terms of the relation of an exception to a legitimate subject of state regulation balanced against the potential burden on commerce.

<u>RECOMMENDATION A</u>:

Delaware without embellishment. Trigger at 15%; 3 year prohibition; 7 exceptions, including prior board approval, 85% purchaser, 2/3 disinterested shareholder approval and auction exceptions (see attached for more detailed discussion); no explicit buyer conditions imposed.

PROS:

Upheld at the Federal District Court level in several cases.

Focus on two-step mergers and under-financed/over-leveraged offers addresses both shareholder and stakeholder abuses, supporting argument that it represents balanced approach designed to deter only abusive takeovers.

CONS:

Provides Massachusetts firms with no more than is easily available to them by re-incorporating in Delaware.

By increasing board negotiating power, it may increase the overall bid price (a short-term pro from the shareholder standpoint) which could have the perverse effect of inducing the sale of more assets following a highly-leveraged, 85% purchase.

As the offer price goes up, places increasing pressure on directors to accept on behalf of shareholders.

Does little to prevent firm from being put in play to gain market profits.

RECOMMENDATION B:

New York/New Jersey without embellishment. Trigger 10%; 5 year prohibition; prior board approval only exception; no specific buyer conditions imposed.

PROS:

Creates formidable disincentive to any hostile bid, whether efficiency producing or not.

Strengthens board negotiating position, driving up offer price to short-term benefit of shareholders.

CONS:

Quite possibly an unconstitutional burden on interstate commerce.

Same problem re potential perverse impact of driving up offer price leading to more assets sold at greater stakeholder cost.

Places tremendous pressure on board to accept adequately financed offer.

Provides Massachusetts firms with nothing they could not easily get by re-incorporating in New York or New Jersey.

Does little to prevent firms being put in play.

RECOMMENDATION C:

Martin Lipton's "third generation" business combination statute (see attached).

PROS:

1% threshold would appear to prevent firms from being put into play successfully.

CONS:

No experience with it to date; quite possibly unconstitutional

Otherwise, same as above.

RECOMMENDATION D:

One of the above together with the following specific buyer conditions:

1)(a) adoption fiduciary standard which mandates and specifies what constitutes adequate consideration of stakeholder interests in a board decision to opt out of coverage and thus to avoid the business combination prohibition;

(b) adoption of governance standards to require stakeholder representation on the board for it to make the opt-out decision; and

(c) requirement for "hostile" acquirors that do opt-out to establish trust fund to cover the potential dislocation costs of each employee, including at least RAB and ISP costs, to be placed under state control for the next 2 years.

2) requirement for recognition of existing union and succession clauses for collective bargaining agreements;

3) mandatory 90 day notice or 90 day severance based on standard RAB calculation;

4) other buyer conditions.

PROS:

Same as (B) with following modifications:

Expands protection to Massachusetts stakeholders beyond what is available under any other state law.

Provides added protections for stakeholders of corporation subject to hostile takeover and which might, therefore, reasonably be assumed to be an "at risk" population.

Increases incentives for friendly takeovers in order to avoid buyer conditions.

CONS:

Same as (B) with following modifications:

Limits applicability of buyer conditions to hostile takeovers raising concerns re inequitable treatment of dislocated workers and differential standards of conduct for new and incumbent managements, of particular concern given anecdotal evidence re impact of leveraged buyouts.

Discriminatory application of such standards of conduct undermine the argument that they are imposed for reasons other than that of creating barriers to takeovers rather than legitimate business and economic regulation within state authority. (This discriminatory

application issue intensifies as more exceptions the business combination prohibition are included since it by definition becomes more difficult to be a "hostile" bidder.)

Creates specific bias against hostile takeovers of labor intensive operations which in many cases, although by no means all, may provide the largest long-term social and economic benefits by re-allocating resources, both capital and labor, to more efficient uses.

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MEMORANDUM

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: September 28, 1988

RE: DELAWARE TRIGGER AND OWNERSHIP THRESHOLDS AND PROHIBITION PERIODS - UPDATE

GENERAL PROPOSAL:

Submit legislation using the exceptions to the business combination prohibition contained in the Delaware Business Combination Law, Chapter 203, Acts of 1988, as a framework but to consider different trigger and ownership thresholds and prohibition periods as well as extended coverage to publicly held corporations organized under chapters other than M.G.L. c. 156B to better protect the interests of shareholders and stakeholders in Massachusetts corporations.

BACKGROUND:

At the August 31 Commission meeting, the members voted virtually unanimously (one abstention) in support of a recommendation to supplement the state's control share acquisition statutes with a business combination law based on the framework of exceptions found in the Delaware statute, the most important of which include:

1) pre-trigger board approval of the transaction;

2) free participation of an "interested shareholder" in an auction;

3) avoidance of business combination prohibition by purchasing 85% or more of outstanding shares, excluding those owned by management or ESOPs; and

4) post-trigger board approval plus 2/3 disinterested shareholder ratification.

This vote was taken with the understanding that decisions relating to possible trigger thresholds (1-15%) and prohibition periods (3-5 years) would be deferred to the next Commission meeting. The specific recommendations made for future Commission consideration were:

1) lower the trigger threshold defining an "interested shareholder" and, therefore, the application of the Act from 15% to 5%; and

2) increase the prohibition period for business combinations by an "interested shareholder" from 3 to 5 years.

Both proposals were made to make the business combination proposal more effective by strengthening its deterrent effects on two-step mergers and under-financed and/or over-leveraged takeovers. The general effect of both proposals is to provide increased incentives to a potential buyer to negotiate directly with the board of directors or to ensure its offer is sufficient to acquire an 85% interest in the target to avoid the business combination prohibition. Lowering the trigger threshold would appear to have the added benefit of deterring "creeping" tender offers or significant purchases of stock that can be used for greenmail purposes. If lowered too far, it might interfere with the investment patterns of institutional investors.

Two related issues not yet considered by the Commission which might increase the effectiveness of a business combination type proposal were not discussed:

1) raising the ownership threshold required to avoid the business combination prohibition from 85% to 90%; and

2) extending application of a business combination type statute to non-156B corporations that are publicly held, such as banks and insurance companies.

Raising the ownership threshold required for an "interested shareholder" to avoid the business combination prohibition from 85% to 90% or higher would be consistent with the other proposals made to increase incentives to negotiate with the board of directors. However, tightening up this exception by raising the threshold may raise concerns about the constitutionality of a business combination law. One of the grounds for upholding the Delaware law to date has been that it is not designed to stop hostile takeovers and that the 85% exception gives hostile offerors a meaningful opportunity to consummate their offers and receive full control despite management opposition. BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988) and RP Acquisition Corp., v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988). The attached data provided by Professor Margotta indicates that in a sample of tender offers between 1982-7, more than 75% of the offers that began as hostile ended with the buyer owning 85% or more of the target. It is important to note that these numbers pre-date the Delaware statute that made obtaining an 85% share an

an important consideration in a hostile takeover. This data should provide strong support for the argument that the Delaware statute does not represent an unconstitutional burden on interstate commerce. However, it also may raise concerns about the Delaware law's effectiveness as a disincentive to takeovers. Raising the exception threshold to 90% or more could make the statute a more effective deterrent. However, such a change could also undermine arguments in support of its constitutionality, particularly if combined with a lowered trigger threshold and/or a lengthened business combination prohibition period. We are currently examining the attached data to determine what relation there may be between the trigger threshold and final ownership level.

The exclusion of non-156B publicly held corporations from coverage by the Massachusetts Control Share Acquisition Act was essentially a procedural rather than a substantive policy decision. The Boston Bar Association Committee that drafted M.G.L. c. 110D & 110E included a representative from the Corporations Division of the Secretary of State's Office. However, Massachusetts has several laws regulating the incorporation and governance of different types of publicly held corporations. While the Secretary of State regulates 156B corporations, the organization and governance of banks and insurance companies is regulated under separate laws by the Commissioners of Banking and of Insurance within the Executive Office of Consumer Affairs and Business Regulation. In order to avoid any inadvertent jurisdictional conflicts that might result from inclusion of banks and insurance companies, the BBA drafting committee decided to exclude non-156B corporations. There appears to have been no substantive rationale for this decision other than that time constraints made it impossible for the committee to ensure that the inclusion of banks and insurance companies in a control share acquisition law would not create problems. Therefore, Commission consideration of the inclusion of non-156B corporations within the protections of M.G.L. c. 110D & 110E as well as any proposed business combination act would appear to be a relevant issue which should be explored with the Secretary of Consumer Affairs and Business Regulation and the Commissioners of Banking and of Insurance.

<u>RECOMMENDATION A</u>:

Lower trigger defining "interested shareholder" from the 15% contained in the Delaware law to 5%.

PROS:

Increases board negotiating power on behalf of both shareholders and stakeholders by increasing buyer incentives to approach the board earlier in process before it has obtained a substantial interest in the target.

Deters "creeping" tender offers and/or investors with no interest in gaining control from purchase of sufficient shares to put company in play for margin profits or to force greenmail.

Would make trigger for Massachusetts business combination law consistent with that of M.G.L. c. 110C as well as the Williams Act simplifying filing/enforcement issues.

Would provide Massachusetts firms and their shareholders and stakeholders with greater protection from coercive two-step mergers and the abuses associated with under-financed and/or over-leveraged takeovers than currently available under any regulatory scheme with substantial likelihood of meeting constitutional scrutiny.

CONS:

If lowering the trigger significantly reduced a hostile offeror's ability to obtain 85% (or more) of the outstanding shares to avoid the business combination prohibition, this would substantially undercut the constitutionality of the proposal.

If the trigger were set at 1% or lower, it could begin to interfere with current patterns of institutional investment.

<u>RECOMMENDATION B</u>:

Extend business combination prohibition period from 3 to 5 years.

PROS:

Increases board negotiating power on behalf of both shareholders and stakeholders by increasing buyer incentives to approach the board before beginning a control share transaction or by encouraging fully financed tenders for a vast majority of the outstanding shares (85% or more) by increasing disincentive for triggering the statute without falling within one of its exceptions.

Would provide Massachusetts firms and their shareholders and stakeholders with greater protection from coercive two-step mergers and the abuses associated with under-financed and/or over-leveraged takeovers than currently available under any regulatory scheme with substantial likelihood of meeting constitutional scrutiny.

CONS:

A longer business combination period may be interpreted by the courts as an attempt to prevent takeovers rather than as a legitimate exercise of state corporate and economic regulatory authority designed to protect the interests of domestic corporations and their shareholders and stakeholders.

RECOMMENDATION C:

Increase the "interested shareholder" ownership level required to avoid the business combination prohibition from 85% to 90%.

PROS:

Increases board negotiating power on behalf of both shareholders and stakeholders by increasing buyer incentives to approach the board before beginning a control share transaction or by encouraging fully financed tenders for a vast majority of the outstanding shares (90% or more) by increasing disincentive for triggering the statute without falling within one of its exceptions.

Would provide Massachusetts firms and their shareholders and stakeholders with greater protection from coercive two-step mergers and the abuses associated with under-financed and/or over-leveraged takeovers than currently available under any regulatory scheme with substantial likelihood of meeting constitutional scrutiny.

CONS:

If increasing the "interested shareholder" ownership level for avoiding the business combination prohibition significantly reduced a hostile offeror's ability to become eligible for this exception, this could substantially undercut the proposal's constitutionality, particularly if combined with a lower trigger level.

RECOMMENDATION D:

Cover not only 156B corporations but other publicly held corporations such as banks and insurance companies as well.

PROS:

Would treat all Massachusetts publicly held corporations and their shareholders and stakeholders alike in this context.

CONS:

9/21/88

Ms. Barbara Waters, Deputy General Counsel
Executive office of Economic Affairs
One Ashburton Place, Room 2101

Dear Barbara,

As discussed yesterday, the attached two tables will add further insight into reasonable trigger points and/or exception limits of a Delaware-type statute, if this is the direction the Commission decides to take.

Table 3 shows that of the 162 hostile transactions from 1981 through April 1988, 22 launched a tender offer from a position of less than 1% and ended up with more than 95% of the outstanding shares. The following table lists outcomes for various triggers and exceptions based on these data:

Trigger	Exception	Number (%) of hostile transactions which would have been excepted.	Number(%) of friendly transactions which would have been excepted. (*)
1%	95%	25 (15.4%)	82 (27.6%)
1%	90%	56 (34.5%)	140 (47.0%)
1%	85%	73 (45.0%)	154 (51.0%)
5%	95%	28 (17.2%)	89 (29.9%)
5%	90%	63 (38.8%)	151 (50.0%)
5%	85%	83 (51.2%)	167 (56.0%)
10%	95%	33 (20.3%)	93 (31.3%)
10%	90%	73 (45.0%)	158 (53.0%)
10%	85%	96 (59.2%)	176 (59.0%)
15%	95%	34 (20.9%)	96 (32.3%)
15%	90%	77 (47.5%)	165 (55.0%)
15%	85% (Delaware)	99 (61.1%)	184 (61.0%)

(*) Restrictions do not apply to negotiated (friendly) transactions - these numbers only for comparison.

Let me know if you want to discuss these further.

Sincerely,

Don Margotta

cc: Mr. Joe Alviani
Secretary of Economic Affairs

TABLE 3
SUMMARY STATISTICS ON INITIAL ACQUIROR FOOTHOLD "PRIOR" TO LAUNCHING A TENDER OFFER, AND RESULTING OWNERSHIP

I. HOSTILE TRANSACTIONS WHICH STARTED HOSTILE, AND ENDED HOSTILE

NUMBER OF CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	3	2	2	3	10
STARTED >1% BUT <5%	1	0	0	4	5
STARTED >5% BUT <10%	2	0	2	4	8
STARTED AT >10%	0	4	1	3	8
TOTALS	6	6	5	14	31

II. HOSTILE TRANSACTIONS WHICH STARTED HOSTILE, AND ENDED FRIENDLY

NUMBER OF CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	22	29	15	19	85
STARTED >1% BUT <5%	2	4	3	3	12
STARTED >5% BUT <10%	3	5	1	3	12
STARTED AT >10%	4	8	5	5	22
TOTALS	31	46	24	30	131

III. ALL HOSTILE TRANSACTIONS

NUMBER OF CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	25	31	17	22	95
STARTED >1% BUT <5%	3	4	3	7	17
STARTED >5% BUT <10%	5	5	3	7	20
STARTED AT >10%	4	12	6	8	30
TOTALS	37	52	29	44	162

PERCENTAGE OF TOTAL HOSTILE CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	15.4%	19.1%	10.5%	13.6%	58.6%
STARTED >1% BUT <5%	1.9%	2.5%	1.9%	4.3%	10.5%
STARTED >5% BUT <10%	3.1%	3.1%	1.9%	4.3%	12.3%
STARTED AT >10%	2.5%	7.4%	3.7%	4.9%	18.5%
TOTALS	22.8%	32.1%	17.9%	27.2%	100.0%

TABLE 4

SUMMARY STATISTICS ON INITIAL ACQUIROR FOOTHOLD "PRIOR" TO LAUNCHING A TENDER OFFER, AND RESULTING OWNERSHIP

I. ALL FRIENDLY TRANSACTIONS

NUMBER OF CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	82	58	14	25	179
STARTED >1% BUT <5%	7	4	2	5	18
STARTED >5% BUT <10%	4	3	2	2	11
STARTED AT >10%	34	33	8	14	89
TOTALS	127	98	26	46	297

PERCENTAGE OF TOTAL HOSTILE CASES WHERE "PRIOR," OR INITIAL ACQUIROR POSITION STARTED BELOW A SPECIFIED %, AND AFTER OFFER OWNED % SHOWN

"PRIOR" POSITION	% OWNED AFTER TENDER OFFER				
	>95%	90-95	85-90	<85%	TOTAL
STARTED AT <1%	27.6%	19.5%	4.7%	8.4%	60.3%
STARTED >1% BUT <5%	2.4%	1.3%	0.7%	1.7%	6.1%
STARTED >5% BUT <10%	1.3%	1.0%	0.7%	0.7%	3.7%
STARTED AT >10%	11.4%	11.1%	2.7%	4.7%	30.0%
TOTALS	42.8%	33.0%	8.8%	15.5%	100.0%

'203 BUSINESS COMBINATIONS WITH INTERESTED STOCKHOLDERS.—

(a) Notwithstanding any other provisions of this chapter, a corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder, unless (1) prior to such date the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder, or (2) upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned (i) by persons who are directors and also officers and (ii) employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer, or (3) on or subsequent to such date the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66⅔% of the outstanding voting stock which is not owned by the interested stockholder.

(b) The restrictions contained in this section shall not apply if:

(1) the corporation's original certificate of incorporation contains a provision expressly electing not to be governed by this section;

(2) the corporation, by action of its board of directors, adopts an amendment to its bylaws within 90 days of the effective date of this section, expressly electing not to be governed by this section, which amendment shall not be further amended by the board of directors.

(3) the corporation, by action of its shockholders, adopts an amendment to its certificate of incorporation or bylaws expressly electing not to be governed by this section, provided that, in addition to any other vote required by law, such amendment to the certificate of incorporation or bylaws must be approved by the affirmative vote of a majority of the shares entitled to vote. An amendment adopted pursuant to this paragraph shall not be effective until 12 months after the adoption of such amendment and shall not apply to any business combination between such corporation and any person who became an interested stockholder of such corporation on or prior to such adoption. A bylaw amendment adopted pursuant to this paragraph shall not be further amended by the board of directors;

(4) the corporation does not have a class of voting stock that is (i) listed on a national securities exchange, (ii) authorized for quotation on an inter dealer quotation system of a registered national securities association or (iii) held of record by more than 2,000 stockholders, unless any of the foregoing results from action taken, directly or indirectly, by an interested stockholder or from a transaction in which a person becomes an interested stockholder;

(5) a stockholder becomes an interested stockholder inadvertently and (i) as soon as practicable divests sufficient shares so that the stockholder ceases to be an interested stockholder and (ii) would not, at any time within the 3 year period immediately prior to a business combination between the corporation and such stockholder, have been an interested stockholder but for the inadvertent acquisition; or

(6) the business combination is proposed prior to the consummation or abandonment of and subsequent to the earlier of the public announcement or the notice required hereunder of a proposed transaction which (i) constitutes one of the transactions described in the second sentence of this paragraph; (ii) is with or by a person who either was not an interested stockholder during the previous 3 years or who became an interested stockholder with the approval of the corporation's board of directors; and (iii) is approved or not opposed by a majority of the members of the board of directors then in office (but not less than 1) who were directors prior to any person becoming an interested stockholder during the previous 3 years or were recommended for election or elected to succeed such directors by a majority of such directors. The proposed transactions referred to in the preceding sentence are limited to (x) a merger or consolidation of the corporation (except for a merger in respect of which, pursuant to section 251 (f) of the chapter, no vote of the stockholders of the corporation is required); (y) a sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions), whether as part of a dissolution or otherwise, of assets of the corporation or of any direct or indirect majority-owned subsidiary of the corporation (other than to any direct or indirect wholly-owned subsidiary or to the corporation) having an aggregate market value equal to 50% or more of either that aggregate market value of all of the assets of the cor-

poration determined on a consolidated basis or the aggregate market value of all the outstanding stock of the corporation; or (z) a proposed tender or exchange offer for 50% or more of the outstanding voting stock of the corporation. The corporation shall give not less then 20 days notice to all interested stockholders prior to the consummation of any of the transactions described in clauses (x) or (y) of the second sentence of this paragraph. Notwithstanding paragraphs (1), (2), (3) and (4) of this subsection, a corporation may elect by a provision of its original certificate of incorporation or any amendment thereto to be governed by this section, provided that any such amendment to the certificate of incorporation shall not apply to restrict a business combination between the corporation and an interested stockholder of the corporation if the interested stockholder became such prior to the effective date of the amendment.

(c) As used in this section only, the term:

(1) "affiliate" means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, another person.

(2) "associate," when used to indicate a relationship with any person, means (i) any corporation or organization of which such person is a director, officer or partner or is, directly or indirectly, the owner of 20% or more of any class of voting stock, (ii) any trust or other estate in which such person has at least a 20% beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (iii) any relative or spouse of such person, or any relative of such spouse, who has the same residence as such person.

(3) "business combination," when used in reference to any corporation and any interested stockholder of such corporation, means:

(i) any merger or consolidation of the corporation or any direct or indirect majority-owned subsidiary of the corporation with (A) the interested stockholder, or (B) with any other corporation if the merger or consolidation is caused by the interested stockholder and as a result of such merger or consolidation subsection (a) of this section is not applicable to the surviving corporation;

(ii) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions), except proportionately as a stockholder of such corporation, to or with the interested stockholder, whether as part of a dissolution or otherwise, of assets of the corporation or of any direct or indirect majority-owned subsidiary of the corporation which assets have an aggregate market value equal to 10% or more of either the aggregate market value of all the assets of the corporation determined on a consolidated basis or the aggregate market value of all the outstanding stock of the corporation;

(iii) any transaction which results in the issuance or transfer by the corporation or by any direct or indirect majority-owned subsidiary of the corporation of any stock of the corporation or of such subsidiary to the interested stockholder, except (A) pursuant to the exercise, exchange or conversion of securities exercisable for, exchangeable for or convertible into stock of such corporation or any such subsidiary which securities were outstanding prior to the time that the interested stockholder became such, (B) pursuant to a dividend or distribution paid or made, or the exercise, exchange or conversion of securities exercisable for, exchangeable for or convertible into stock of such corporation or any such subsidiary which security is distributed, pro rata to all holders of a class or series of stock of such corporation subsequent to the time the interested stockholder became such, (C) pursuant to an exchange offer by the corporation to purchase stock made on the same terms to all holders of said stock, or (D) any issuance or transfer of stock by the corporation, provided however, that in no case under (B)—(D) above shall there be an increase in the interested stockholder's proportionate share of the stock of any class or series of the corporation or of the voting stock of the corporation;

(iv) any transaction involving the corporation or any direct or indirect majority-owned subsidiary of the corporation which has the effect, directly or indirectly, of increasing the proportionate share of the stock of any class or series, or securities convertible into the stock of any class or series, of the corporation or of any such subsidiary which is owned by the interested stockholder, except as a result of immaterial changes due to fractional share adjustments or as a result of any purchase or redemption of any shares of stock not caused, directly or indirectly, by the interested stockholder; or

(v) any receipt by the interested stockholder of the benefit, directly or indirectly (except proportionately as a stockholder of such corporation) of any loans, advances, guarantees, pledges, or other financial benefits (other than those expressly permitted in subparagraphs (i)-(iv) above) provided by or through the corporation or any direct or indirect majority owned subsidiary.

(4) "control," including the term "controlling," "controlled by" and "under common control with," means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract, or otherwise. A person who is the owner of 20% or more of a corporation's outstanding voting stock shall be presumed to have control of such corporation, in the absence of proof by a preponderance of the evidence to the contrary. Notwithstanding the foregoing, a presumption of control shall not apply where such person holds voting stock, in good faith and not for the purpose of circumventing this section, as an agent, bank, broker, nominee, custodian or trustee for one or more owners who do not individually or as a group have control of such corporation.

(5) "interested stockholder" means any person (other than the corporation and any direct or indirect majority-owned subsidiary of the corporation) that (i) is the owner of 15% or more of the outstanding voting stock of the corporation, or (ii) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within the 3-year period immediately prior to the date on which it is sought to be determined whether such person is an interested stockholder; and the affiliates and associates of such person; provided, however, that the term "interested stockholder" shall not include (x) any person who (A) owned shares in excess of the 15% limitation set forth herein as of, or acquired such shares pursuant to a tender offer commenced prior to, December 23, 1987, or pursuant to an exchange offer announced prior to the aforesaid date and commenced within 90 days thereafter and continued to own shares in excess of such 15% limitation or would have but for action by the corporation or (B) acquired said shares from a person described in (A) above by gift, inheritance or in a transaction in which no consideration was exchanged; or (y) any person whose ownership of shares in excess of the 15% limitation set forth herein in the result of action taken solely by the corporation provided that such person shall be an interested stockholder if thereafter he acquires additional shares of voting stock of the corporation, except as a result of further corporate action not caused, directly or indirectly, by such person. For the purpose of determining whether a person is an interested stockholder, the voting stock of the corporation deemed to be outstanding shall include stock deemed to be owned by the person through application of paragraph (8) of this subsection but shall not include any other unissued stock of such corporation which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

(6) "person" means any individual, corporation, partnership, unincorporated association or other entity.

(7) "voting stock" means stock of any class or series entitled to vote generally in the election of directors.

(8) "owner" including the terms "own" and "owned" when used with respect to any stock means a person that individually or with or through any of its affiliates or associates:

(i) beneficially owns such stock, directly or indirectly; or

(ii) has (A) the right to acquire such stock (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise; provided, however, that a person shall not be deemed the owner of stock tendered pursuant to a tender or exchange offer made by such person or any of such person's affiliates or associates until such tendered stock is accepted for purchase or exchange; or (B) the right to vote such stock pursuant to any agreement, arrangement or understanding; provided, however, that a person shall not be deemed the owner of any stock because of such person's right to vote such stock if the agreement, arrangement or

understanding to vote such stock arises solely from a revocable proxy or consent given in response to a proxy or consent solicitation made to 10 or more persons; or

(iii) has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting (except voting pursuant to a revocable proxy or consent as described in item (B) of clause (ii) of this paragraph), or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

(d) No provision of a certificate of incorporation or bylaw shall require, for any vote of stockholders required by this section a greater vote of stockholders than that specified in this section.

(e) The Court of Chancery is hereby vested with exclusive jurisdiction to hear and determine all matters with respect to this section. (Added by Ch. 204, L.'88, eff. 2-2-88.)

Prior to its repeal by Ch. 136, L. '87, eff. 7-1-87, former section 203 read: 'TENDER OFFERS.—"(a) No offeror shall make a tender offer unless:

(1) Not less than 20 nor more than 60 days before the date the tender offer is to be made, the offeror shall deliver personally or by registered or certified mail to the corporation whose equity securities are to be subject to the tender offer, at its registered office in this State or at its principal place of business, a written statement of the

offeror's intention to make the tender offer. The statement shall include the name and address of the offeror and of each director and principal officer of the offeror; a description of the equity securities to be purchased and the consideration to be offered; the duration of the offer; the date on which the offeror may first purchase tendered securities; the amount or number of equity securities to be purchased or the manner in which such number or amount will be determined; whether the offeror will unconditionally accept all or any part of the equity securities tendered and, if not, upon what conditions acceptance will be made; the number or amount of any equity securities of the corporation owned beneficially by the offeror and any associate of the offeror as of the date of the delivery of the statement; a description of any contract, agreement or understanding to which the offeror or any associate of the offeror is a party with respect to the ownership, voting rights or any other interest in any equity security of the corporation; and, if the offeror permits the purchase of less than all the outstanding equity securities issued by the corporation, copies of a balance sheet of the offeror as of the end of its last fiscal year and of its income statements for the 3 fiscal years preceding the offer;

(2) The tender offer shall remain open for a period of at least 20 days after it is first made to the holders of the equity securities, during which period any stockholder may withdraw any of the equity securities tendered to the offeror, and any revised or amended tender offer which changes the amount or type of consideration offered or the number of equity securities for which the offer is made shall remain open at least 10 days following the amendment; and

(3) The offeror and any associate of the offeror will not purchase or pay for any tendered equity security for a period of at least 20 days after the tender offer is first made to the holders of the equity securities, and no such purchase or payment shall be made within 10 days after an amended or revised tender offer if the amendment or revision changes the amount or type of consideration offered or the number of equity securities for which the offer is made. If during the period the tender offer must remain open pursuant to this section, a greater number of equity securities is tendered than the offeror is bound or willing to purchase, the equity securities shall be purchased pro rata, as nearly as may be, according to the number of shares tendered during such period by each equity security holder.

(b) Notwithstanding the foregoing:

(1) Whenever an offeror has delivered the statement required by paragraph (1) of subsection (a) of this section, a subsequent offeror who shall also deliver the statement required by paragraph (1) of subsection (a) of this section may thereafter make a tender offer for equity securities of the same class as in the original offer at or after the date this section permits the original offeror to make an offer.

(2) If the original offeror has made a tender offer in compliance with this section, the date upon which a subsequent offer for equity securities of the same class may close and the offeror purchase or pay for equity securities tendered thereunder may be the same as provided in the original offer at the date the subsequent offer is made.

(c) As used in this section, the term:

(1) "Offeror" means any person, corporation, partnership, unincorporated association or other entity who makes a tender offer, and includes any 2 or more of the same who make a tender offer jointly or intend to exercise jointly or in concert any voting rights of the equity securities for which the tender offer is made

(2) "Tender offer" means any offer to purchase or invitation to tender equity securities for purchase made by an offeror to more than 30 of the holders of equity securities of any corporation organized under this chapter if, after the consummation thereof, the offeror and any associate of the offeror would own beneficially, directly or indirectly, more than 5 percent of any class of the outstanding equity securities of the corporation, unless the offer is exempted by any other provision of this section.

(3) "Tender offer" does not mean:

a. An offer made by a corporation to purchase its own equity securities or equity securities of another corporation, if a majority of the shares entitled to vote in the election of directors of such corporation is held directly or indirectly by the offering corporation;

b. An offer to purchase equity securities to be effected by a registered broker-dealer on a stock exchange or in the over-the-counter market if the broker performs only the customary broker's function, and receives no more than the customary broker's commissions, and neither the principal nor the broker solicits or arranges for the solicitation of orders to sell such equity securities.

(4) A tender offer is "made" when it is first published or sent or given to the holders of the equity securities

(5) "Equity security" means any stock, bond or other obligation the holder of which has the right to vote, or any security convertible into, or any right, option or warrant to purchase any such stock, bond or other obligation.

(6) "Associate of the offeror" means:

a. Any corporation or other organization of which the offeror is an officer, director or partner, or is, directly or indirectly, the beneficial owner of 10% or more of any class of equity securities;

b. Any person who is an officer, director, partner or managing agent of an offeror, or who is, directly or indirectly, the beneficial owner of 10% or more of any class of equity securities of the offeror;

c. Any trust or other estate in which the offeror has a substantial beneficial interest or as to which the offeror serves as trustee or in a similar fiduciary capacity; or

d. The spouse of the offeror, or any relative of the offeror or of such spouse who has the same home as the offeror.

(d) The certificate of incorporation of any corporation organized under this chapter may provide that tender offers for the purchase of its equity securities shall not be subject to this section

(e) The Court of Chancery is hereby vested with exclusive jurisdiction summarily to hear and determine alleged violations of this section. The Court may, in its discretion, award such relief as it may deem just and proper, including directing the corporation to refuse to transfer on its books and to refuse to recognize the vote with respect to any equity security acquired pursuant to a tender offer which does not comply with or is not exempt under this section.

.1 **Constitutionality.**—Court permanently bars officers of target company from enforcing provisions of Delaware Tender Offers Act against tender offeror because Act

causes unnecessary burden on interstate commerce and is pre-empted by Williams Act (the Federal Business Take-Over Act). ***Dart Industries, Inc. v Conrad (DC S.D. Ind. 1978) 462 F Supp 1.***

Tender offer that specified 10-day proration period was upheld as in accord with federally permissible time table even though Delaware's statutory minimum proration period is 20-days; Delaware provision violates Supremacy Clause as inconsistent with federal Williams Act. *Burlington Northern Inc v The El Paso Co (DC Del 1982) Civ Act No 82-818, 12-28-82.*

Court refused to grant tender offeror temporary restraining order enjoining target and attorney general from attempting to enforce Delaware Tender Offer Act because (1) there is no likelihood that Act will be enforced against tender offeror when everyone concedes that Act is unconstitutional and (2) process is "meaningless charade" that is waste of time and energy to all involved. *Loral Corporation v Sanders Associates, Inc. (DC Del 1986) Civil Action No. 86-296 MMS, 7-16-86.*

.2 Class action.—In class action for alleged fraudulent tender offer by defendants, stockholder is entitled to counsel fees and expenses, even though he wasn't defrauded seller and hadn't relied on deceptions charged; he can recover counsel fees and expenses from defendants by showing he created substantial benefits for others in same class, and that they "brazenly" settled such class action without consulting him in violation of Rule 23 of Federal Rules of Civil Procedure. *Kahan v Rosenstiel (CA-3, 1970) 424 F2d 161.*

.3 Information required.—Statute calling for tender offeror to furnish its balance sheet and income statements prior to making of tender offer was complied with when offeror gave a consolidated balance sheet and consolidated income statements of parent and subsidiaries, since those actually gave offeree information statute desired. *Monogram Industries, Inc. v Royal Industries, Inc. (SCt, 1976) 367 A2d 650.*

Tender offer enjoined unless supplemented by disclosures of net worth of individuals and estimate of personal assets used to secure bank loan because these aspects bear on stock tender offering price. *Pabst Brewing Co v Kalmanovitz (DC Del 1982) No 82-711 11-17-82.*

.4 Antifraud rule actions.—Stockholder could bring antifraud suit when corporation announced tender offer to buy up shares of his company at stipulated price and upon obtaining over 90% of shares consummated short-form merger in accordance with state law, giving remaining stockholders same stipulated price, since stockholder became forced seller and failure to state that he could seek appraisal rights was material omission; however, there was no obligation to disclose per-share earnings in tender offer material since such data was readily available in financial reports. *Valente v Pepsico, Inc. (DC D. Del. 1978) 454 F Supp 1228.*

.5 Fiduciary Duty.—Tender offeror, which acquired approximately 34.8% of target's stock, and its stockholders owed target no fiduciary duty because they didn't exercise control over target's affairs. *Lewis v Knutson (CA-5, 1983) 699 F2d 230.*

Tender offer by majority stockholder corporation to obtain stock held by minority in order to boost majority's holdings to 90% so it could effectuate short-form merger was enjoined because majority violated its fiduciary duty to offer fair price and make full disclosure to minority. *Joseph v Shell Oil Company (Ct. of Ch. 1984) 482 A2d 335.*

Tender offeror that terminated first tender offer in favor of second offer which denied participation to some shareholders wasn't liable to those shareholders after they sold their shares in open market at substantial discount under offer price. Offeror owed no duty to target's shareholders and had unqualified right to terminate first tender offer upon occurrence of events specified in tender offer. However, offeror could be liable for conspiracy with target if target breached its fiduciary duty to shareholders with offeror's knowing participation. *Gilbert v The El Paso Company (Ct. of Ch. 1984) Civil Action Nos 7075 and 7079, 11-27-84.*

Shareholder denied preliminary injunction restraining corporation and directors from issuing stock at stock sale because board hadn't breached fiduciary duty when it withdrew from stockholders, at stockholders' meeting, right to vote on bylaw amendment that repealed existing limitation on number of shares stockholders could own and then adopted amendment itself during meeting recess; it wasn't *per se* breach of fiduciary duty for directors to act against majority shareholders' wishes because there were other factors that directors could consider when exercising business judgment. *American International Rent A Car Inc. v Cross (Ct. of Ch. 1984) Civil Action No 7583, 5-9-84.*

Target's directors violated fiduciary duty to shareholders by granting lock-up and no-shop guarantees to white knight in exchange for protection of rights of holders of notes that target had exchanged earlier for stock in order to deter takeover by hostile tender offeror. Lock-up and no-shop guarantees harmed shareholders because guarantees foreclosed further bidding in active bidding situation and were made in directors' self-interest because they promoted agreement that relieved directors of potentially damaging consequences (suit by noteholders) of their own defensive policies. Although concern for noteholders is proper when addressing takeover threat, concern is inappropriate when active bidding is taking place and object no longer is to protect or maintain corporate enterprise, but to sell it. "Poison pill" rights plan and exchange plan initially adopted by directors were valid as prospective devices calculated to strengthen board's bargaining position but, when corporation's

sale became inevitable, whole question of defensive measures became moot. ***Revlon, Inc. v MacAndrews & Forbes Holdings, Inc. (S Ct 1986) Nos. 353 & 354, 3-13-86.***

Corporation and directors breached fiduciary duty to minority shareholders because (1) disclosures made in leveraged cash tender offer failed to adequately show basis for book value of land, which was corporation's primary asset or adequately disclose method used to arrive at tender offer price and (2) method used to select tender offer price wasn't likely to assure that minority shareholders would receive true value for their shares. *Kahn v United States Sugar Corporation (Ct of Ch 1985) Civil Action No. 7313, 12-10-85.*

Court dismissed shareholders' class actions claiming that president and director breached their fiduciary duties to shareholders by rejecting tender offer in order to maintain their positions in corporation because (1) president didn't control or dominate board or have power to accept or reject proposals on corporation's behalf, (2) press release issued by president was proper since he said he would submit matter to directors, and (3) president and directors didn't extract **stand-still agreement from tender offeror and then violate it by failing to provide confidential information to offeror.** ***Lewis v Straetz (Ct of Ch 1986) Civil Action No. 7859, 2-12-86.***

.6 Violation of federal securities laws.—Shareholder couldn't bring action under Williams Act after she lost opportunity to profit from hostile tender offer (offer was rescinded and tender offeror substituted friendly, less lucrative offer) because she alleged no injury resulting from deception. *Schreiber v Burlington Northern Inc (CA-3, 1984) 731 F2d 163.*

Offeror didn't violate Williams [illegible] proration rules when it withdrew one offer and substituted another allowing target's officers and directors to tender shares because offers were separate and distinct [illegible] separate proration pools; offeror [illegible] properly treat target or its officers [illegible] than tendering shareholders becau[illegible]ements to purchase target's stock [illegible]cognize officer's golden parachutes we[illegible] collateral to

tender offer so Williams Act didn't apply. *Brill v Burlington Northern Inc. (1984) 590 F Supp 893.*

.7 Injunction barring tender offer.—"White knight" couldn't get injunction barring tender offeror from attempting to acquire it after offeror agreed to refrain from attempting to acquire control of target, which "white knight" later acquired and merged with. Reasons: (1) agreement only contemplated control of target not "white knight" and (2) "white knight" didn't succeed to benefit of agreement after merger with target when that wasn't parties' intention. *Mesa Partners v Phillips Petroleum Company 488 A2d 107.*

.8 Business judgment.—Adoption of "poison pill" plan was appropriate exercise of directors' managerial judgment under business judgment rule because (1) rights weren't sham securities, (2) although plan will eliminate hostile two-tier offers for corporation, directors had reason to believe that corporation was vulnerable to takeover, and (3) although plan deters formation of certain proxy efforts, it doesn't limit individual's voting power and only limits impact of partial tender offers deemed destructive of shareholder interests. *Moran v. Household International, Inc. (Ct. of Ch. 1985) Civil Action No 7730, 1-29-85.*

Shareholders couldn't enjoin sale of three subsidiaries because (1) subsidiaries' sale wouldn't constitute sale of "substantially all" of corporation's assets, (2) sale of assets didn't mandate liquidation of corporation, and (3) shareholders were guilty of laches. Shareholders also couldn't enjoin special meeting of shareholders to vote on planned liquidation of parent because (1) three separate votes on plan weren't required and (2) proxy statement wasn't materially misleading. *Bacine v Scharffenberger (Ct. of Ch. 1984) Civil Action No. 7862, 12-10-84.*

Minority shareholders who brought suit against directors for accepting allegedly inequitable tender offer and lock-up agreement couldn't enjoin tender offer and annual shareholders' meeting because directors' decision to accept tender offer and lock-up agreement one month before meeting at which other offers might have materialized was protected by business judgment rule. *Thompson v Enstar Corporation (Ct of Ch 1984) Civil Action Nos 7641 & 7643, 6-20-84.*

SUBCHAPTER VII. MEETINGS, ELECTIONS, VOTING AND NOTICE

211 MEETINGS OF STOCKHOLDERS.—(a) Meetings of stockholders may be held at such place, either within or without this State, as may be designated by or in the manner provided in the bylaws or, if not so designated, at the registered office of the corporation in this State.

(b) An annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws. Any other proper business may be transacted at the annual meeting.

(c) A failure to hold the annual meeting at the designated time or to elect a sufficient number of directors to conduct the business of the corporation shall not affect otherwise valid corporate acts or work a forfeiture or dissolution of the corporation except as may be otherwise specifically provided in this chapter. If the annual meeting for election of directors is not held on the date designated therefor, the directors shall cause the meeting to be held as soon thereafter as convenient. If there be a failure to hold the annual meeting for a period of 30 days after the date designated therefor, or if no date has been designated, for a period of 13 months after the organization of the corporation or after its last annual meeting, the Court of Chancery may summarily order a meeting to be held upon the application of any stockholder *or director*. The shares of stock represented at such meeting, either in person or by proxy, and entitled to vote thereat, shall constitute a quorum for the purpose of such meeting, notwithstanding any provision of the certificate of incorporation or bylaws to the contrary. The Court of Chancery may issue such orders as may be appropriate, including, without limitation, orders designating the time and place of such meeting, the record date for determination of stockholders entitled to vote, and the form of notice of such meeting.

(d) Special meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws.

(e) All elections of directors shall be by written ballot, unless otherwise provided in the certificate of incorporation. (As amended by Ch. 25, L. '81, eff. 3-1-81).

Ch 25, L. '81, eff 3-1-81, added matter in italic

Chapter 915

CORPORATIONS--BUSINESS COMBINATIONS--

RESTRICTIONS AND REQUIREMENTS--DISCLOSURE OF TAKEOVER BIDS

AN ACT to amend the business corporation law, in relation to requirements for certain business combinations and requirements for disclosure regarding corporate takeover bids

Approved December 16, 1985, effective as provided in § 6.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Section five hundred thirteen of the business corporation law is amended by adding a new paragraph (e) to read as follows: § 1

(e) No resident domestic corporation which is subject to the provisions of section nine hundred twelve of this chapter shall purchase or agree to purchase more than ten percent of the stock of the resident domestic corporation from a shareholder for more than the market value thereof unless such purchase or agreement to purchase is approved by the affirmative vote of the board of directors followed by the affirmative vote of the holders of a majority of all outstanding shares entitled to vote thereon at a meeting of shareholders unless the certificate of incorporation requires a greater percentage of the outstanding shares to approve.

The provisions of this paragraph shall not apply when the resident domestic corporation offers to purchase shares from all holders of stock or for stock which the holder has been the beneficial owner of for more than two years.

The terms "resident domestic corporation", "stock", "beneficial owner", and "market value" shall be as defined in section nine hundred twelve of this chapter.

§ 2. Such law is amended by adding a new section nine hundred twelve to read as follows: § 2

§ 912. Requirements relating to certain business combinations. (a) For the purposes of this section:

(1) "Affiliate" means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, a specified person.

(2) "Announcement date", when used in reference to any business combination, means the date of the first public announcement of the final, definitive proposal for such business combination.

(3) "Associate", when used to indicate a relationship with any person, means (A) any corporation or organization of which such person is an officer or partner or is, directly or indirectly, the beneficial owner of

matter in brackets [ ] is old law to be deleted.

§ 2 ten percent or more of any class of voting stock, (B) any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (C) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person.

(4) "Beneficial owner", when used with respect to any stock, means a person:

(A) that, individually or with or through any of its affiliates or associates, beneficially owns such stock, directly or indirectly; or

(B) that, individually or with or through any of its affiliates or associates, has (i) the right to acquire such stock (whether such right is exercisable immediately or only after the passage of time), pursuant to any agreement, arrangement or understanding (whether or not in writing), or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise; provided, however, that a person shall not be deemed the beneficial owner of stock tendered pursuant to a tender or exchange offer made by such person or any of such person's affiliates or associates until such tendered stock is accepted for purchase or exchange; or (ii) the right to vote such stock pursuant to any agreement, arrangement or understanding (whether or not in writing); provided, however, that a person shall not be deemed the beneficial owner of any stock under this item if the agreement, arrangement or understanding to vote such stock (X) arises solely from a revocable proxy or consent given in response to a proxy or consent solicitation made in accordance with the applicable rules and regulations under the Exchange Act and (Y) is not then reportable on a Schedule 13D under the Exchange Act (or any comparable or successor report); or

(C) that has any agreement, arrangement or understanding (whether or not in writing), for the purpose of acquiring, holding, voting (except voting pursuant to a revocable proxy or consent as described in item (ii) of clause (B) of this subparagraph), or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

(5) "Business combination", when used in reference to any resident domestic corporation and any interested shareholder of such resident domestic corporation, means:

(A) any merger or consolidation of such resident domestic corporation or any subsidiary of such resident domestic corporation with (i) such interested shareholder or (ii) any other corporation (whether or not itself an interested shareholder of such resident domestic corporation) which is, or after such merger or consolidation would be, an affiliate or associate of such interested shareholder;

(B) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions) to or with such interested shareholder or any affiliate or associate of such interested shareholder of assets of such resident domestic corporation or any subsidiary of such resident domestic corporation (i) having an aggregate market value equal to ten percent or more of the aggregate market value of all the assets, determined on a consolidated basis, of

§ 2

such resident domestic corporation, (ii) having an aggregate market value equal to ten percent or more of the aggregate market value of all the outstanding stock of such resident domestic corporation, or (iii) representing ten percent or more of the earning power or net income, determined on a consolidated basis, of such resident domestic corporation;

(C) the issuance or transfer by such resident domestic corporation or any subsidiary of such resident domestic corporation (in one transaction or a series of transactions) of any stock of such resident domestic corporation or any subsidiary of such resident domestic corporation which has an aggregate market value equal to five percent or more of the aggregate market value of all the outstanding stock of such resident domestic corporation to such interested shareholder or any affiliate or associate of such interested shareholder except pursuant to the exercise of warrants or rights to purchase stock offered, or a dividend or distribution paid or made, pro rata to all shareholders of such resident domestic corporation;

(D) the adoption of any plan or proposal for the liquidation or dissolution of such resident domestic corporation proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, such interested shareholder or any affiliate or associate of such interested shareholder;

(E) any reclassification of securities (including, without limitation, any stock split, stock dividend, or other distribution of stock in respect of stock, or any reverse stock split), or recapitalization of such resident domestic corporation, or any merger or consolidation of such resident domestic corporation with any subsidiary of such resident domestic corporation, or any other transaction (whether or not with or into or otherwise involving such interested shareholder), proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, such interested shareholder or any affiliate or associate of such interested shareholder, which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class or series of voting stock or securities convertible into voting stock of such resident domestic corporation or any subsidiary of such resident domestic corporation which is directly or indirectly owned by such interested shareholder or any affiliate or associate of such interested shareholder, except as a result of immaterial changes due to fractional share adjustments; or

(F) any receipt by such interested shareholder or any affiliate or associate of such interested shareholder of the benefit, directly or indirectly (except proportionately as a shareholder of such resident domestic corporation) of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by or through such resident domestic corporation.

(6) "Common stock" means any stock other than preferred stock.

(7) "Consummation date", with respect to any business combination, means the date of consummation of such business combination, or, in the case of a business combination as to which a shareholder vote is taken,

§ 2 the later of the business day prior to the vote or twenty days prior to the date of consummation of such business combination.

(8) "Control", including the terms "controlling", "controlled by" and "under common control with", means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract, or otherwise. A person's beneficial ownership of ten percent or more of a corporation's outstanding voting stock shall create a presumption that such person has control of such corporation. Notwithstanding the foregoing, a person shall not be deemed to have control of a corporation if such person holds voting stock, in good faith and not for the the purpose of circumventing this section, as an agent, bank, broker, nominee, custodian or trustee for one or more beneficial owners who do not individually or as a group have control of such corporation.

(9) "Exchange Act" means the Act of Congress known as the Securities Exchange Act of 1934, as the same has been or hereafter may be amended from time to time.

(10) "Interested shareholder", when used in reference to any resident domestic corporation, means any person (other than such resident domestic corporation or any subsidiary of such resident domestic corporation) that

(A) (i) is the beneficial owner, directly or indirectly, of twenty percent or more of the outstanding voting stock of such resident domestic corporation; or

(ii) is an affiliate or associate of such resident domestic corporation and at any time within the five-year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of twenty percent or more of the then outstanding voting stock of such resident domestic corporation; provided that

(B) for the purpose of determining whether a person is an interested shareholder, the number of shares of voting stock of such resident domestic corporation deemed to be outstanding shall include shares deemed to be beneficially owned by the person through application of subparagraph four of this paragraph but shall not include any other unissued shares of voting stock of such resident domestic corporation which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

(11) "Market value", when used in reference to stock or property of any resident domestic corporation, means:

(A) in the case of stock, the highest closing sale price during the thirty-day period immediately preceding the date in question of a share of such stock on the composite tape for New York stock exchange-listed stocks, or, if such stock is not quoted on such composite tape or if such stock is not listed on such exchange, on the principal United States securities exchange registered under the Exchange Act on which such stock is listed, or, if such stock is not listed on any such exchange, the highest closing bid quotation with respect to a share of

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such stock during the thirty-day period preceding the date in question on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or if no such quotations are available, the fair market value on the date in question of a share of such stock as determined by the board of directors of such resident domestic corporation in good faith; and

(B) in the case of property other than cash or stock, the fair market value of such property on the date in question as determined by the board of directors of such resident domestic corporation in good faith.

(12) "Preferred stock" means any class or series of stock of a resident domestic corporation which under the by-laws or certificate of incorporation of such resident domestic corporation is entitled to receive payment of dividends prior to any payment of dividends on some other class or series of stock, or is entitled in the event of any voluntary liquidation, dissolution or winding up of the resident domestic corporation to receive payment or distribution of a preferential amount before any payments or distributions are received by some other class or series of stock.

(13) "Resident domestic corporation" means an issuer of voting stock which:

(A) is organized under the laws of this state and has its principal executive offices and significant business operations located in this state; and

(B) has at least ten percent of its voting stock owned beneficially by residents of this state. For purposes of this section, the residence of a partnership, unincorporated association, trust or similar organization shall be the principal office of such organization.

No resident domestic corporation, which is organized under the laws of this state, shall cease to be a resident domestic corporation by reason of events occurring or actions taken while such resident domestic corporation is subject to the provisions of this section.

(14) "Stock" means:

(A) any stock or similar security, any certificate of interest, any participation in any profit sharing agreement, any voting trust certificate, or any certificate of deposit for stock; and

(B) any security convertible, with or without consideration, into stock, or any warrant, call or other option or privilege of buying stock without being bound to do so, or any other security carrying any right to acquire, subscribe to or purchase stock.

(15) "Stock acquisition date", with respect to any person and any resident domestic corporation, means the date that such person first becomes an interested shareholder of such resident domestic corporation.

(16) "Subsidiary" of any resident domestic corporation means any other corporation of which voting stock, having a majority of the outstanding voting stock of such other corporation, is owned, directly or indirectly, by such resident domestic corporation.

(17) "Voting stock" means shares of capital stock of a corporation entitled to vote generally in the election of directors.

matter in brackets [ ] is old law to be deleted.

§ 2 (b) Notwithstanding anything to the contrary contained in this chapter (except the provisions of paragraph (d) of this section), no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date unless such business combination or the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date is approved by the board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date. If a good faith proposal is made in writing to the board of directors of such resident domestic corporation regarding a business combination, the board of directors shall respond, in writing, within thirty days or such shorter period, if any, as may be required by the Exchange Act, setting forth its reasons for its decision regarding such proposal. If a good faith proposal to purchase stock is made in writing to the board of directors of such resident domestic corporation, the board of directors, unless it responds affirmatively in writing within thirty days or such shorter period, if any, as may be required by the Exchange Act, shall be deemed to have disapproved such stock purchase.

(c) Notwithstanding anything to the contrary contained in this chapter (except the provisions of paragraphs (b) and (d) of this section), no resident domestic corporation shall engage at any time in any business combination with any interested shareholder of such resident domestic corporation other than a business combination specified in any one of subparagraph (1), (2) or (3):

(1) A business combination approved by the board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date, or where the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date had been approved by the board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date.

(2) A business combination approved by the affirmative vote of the holders of a majority of the outstanding voting stock not beneficially owned by such interested shareholder or any affiliate or associate of such interested shareholder at a meeting called for such purpose no earlier than five years after such interested shareholder's stock acquisition date.

(3) A business combination that meets all of the following conditions:

(A) The aggregate amount of the cash and the market value as of the consummation date of consideration other than cash to be received per share by holders of outstanding shares of common stock of such resident domestic corporation in such business combination is a least equal to the higher of the following:

(i) the highest per share price paid by such interested shareholder at a time when he was the beneficial owner, directly or indirectly, of five percent or more of the outstanding voting stock of such resident domestic corporation, for any shares of common stock of the same class

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or series acquired by it (X) within the five-year period immediately prior to the announcement date with respect to such business combination, or (Y) within the five-year period immediately prior to, or in, the transaction in which such interested shareholder became an interested shareholder, whichever is higher; plus, in either case, interest compounded annually from the earliest date on which such highest per share acquisition price was paid through the consummation date at the rate for one-year United States treasury obligations from time to time in effect; less the aggregate amount of any cash dividends paid, and the market value of any dividends paid other than in cash, per share of common stock since such earliest date, up to the amount of such interest; and

(ii) the market value per share of common stock on the announcement date with respect to such business combination or on such interested shareholder's stock acquisition date, whichever is higher; plus interest compounded annually from such date through the consummation date at the rate for one-year United States treasury obligations from time to time in effect; less the aggregate amount of any cash dividends paid, and the market value of any dividends paid other than in cash, per share of common stock since such date, up to the amount of such interest.

(B) The aggregate amount of the cash and the market value as of the consummation date of consideration other than cash to be received per share by holders of outstanding shares of any class or series of stock, other than common stock, of such resident domestic corporation is at least equal to the highest of the following (whether or not such interested shareholder has previously acquired any shares of such class or series of stock):

(i) the highest per share price paid by such interested shareholder at a time when he was the beneficial owner, directly or indirectly, of five percent or more of the outstanding voting stock of such resident domestic corporation, for any shares of such class or series of stock acquired by it (X) within the five-year period immediately prior to the announcement date with respect to such business combination, or (Y) within the five-year period immediately prior to, or in, the transaction in which such interested shareholder became an interested shareholder, whichever is higher; plus, in either case, interest compounded annually from the earliest date on which such highest per share acquisition price was paid through the consummation date at the rate for one-year United States treasury obligations from time to time in effect; less the aggregate amount of any cash dividends paid, and the market value of any dividends paid other than in cash, per share of such class or series of stock since such earliest date, up to the amount of such interest;

(ii) the highest preferential amount per share to which the holders of shares of such class or series of stock are entitled in the event of any voluntary liquidation, dissolution or winding up of such resident domestic corporation, plus the aggregate amount of any dividends declared or due as to which such holders are entitled prior to payment of dividends on some other class or series of stock (unless the aggregate amount of such dividends is included in such preferential amount); and

matter in brackets [ ] is old law to be deleted.

§ 2 (iii) the market value per share of such class or series of stock on the announcement date with respect to such business combination or on such interested shareholder's stock acquisition date, whichever is higher; plus interest compounded annually from such date through the consummation date at the rate for one-year United States treasury obligations from time to time in effect; less the aggregate amount of any cash dividends paid, and the market value of any dividends paid other than in cash, per share of such class or series of stock since such date, up to the amount of such interest.

(C) The consideration to be received by holders of a particular class or series of outstanding stock (including common stock) of such resident domestic corporation in such business combination is in cash or in the same form as the interested shareholder has used to acquire the largest number of shares of such class or series of stock previously acquired by it, and such consideration shall be distributed promptly.

(D) The holders of all outstanding shares of stock of such resident domestic corporation not beneficially owned by such interested shareholder immediately prior to the consummation of such business combination are entitled to receive in such business combination cash or other consideration for such shares in compliance with clauses (A), (B) and (C) of this subparagraph.

(E) After such interested shareholder's stock acquisition date and prior to the consummation date with respect to such business combination, such interested shareholder has not become the beneficial owner of any additional shares of voting stock of such resident domestic corporation except:

(i) as part of the transaction which resulted in such interested shareholder becoming an interested shareholder;

(ii) by virtue of proportionate stock splits, stock dividends or other distributions of stock in respect of stock not constituting a business combination under clause (E) of subparagraph five of paragraph (a) of this section;

(iii) through a business combination meeting all of the conditions of paragraph (b) of this section and this paragraph; or

(iv) through purchase by such interested shareholder at any price which, if such price had been paid in an otherwise permissible business combination the announcement date and consummation date of which were the date of such purchase, would have satisfied the requirements of clauses (A), (B) and (C) of this subparagraph.

(d) The provisions of this section shall not apply:

(1) to any business combination of a resident domestic corporation that does not have a class of voting stock registered with the Securities and Exchange Commission pursuant to section twelve of the Exchange Act, unless the certificate of incorporation provides otherwise; or

(2) to any business combination of a resident domestic corporation whose certificate of incorporation has been amended to provide that such resident domestic corporation shall be subject to the provisions of this section, which did not have a class of voting stock registered with the Securities and Exchange Commission pursuant to section twelve of the Ex-

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§ 4 § 4. Article sixteen of the business corporation law, as added by chapter eight hundred ninety-three of the laws of nineteen hundred seventy-six, subdivisions (a), (e) and (f) of section sixteen hundred one as amended by chapter five hundred eighty-eight of the laws of nineteen hundred seventy-nine, paragraph four of subdivision (b) of section sixteen hundred one as added and subdivision (c) as amended by chapter eight hundred ninety-four of the laws of nineteen hundred seventy-six, sections sixteen hundred two, sixteen hundred four and sixteen hundred five as amended and section sixteen hundred fourteen as added by chapter seven hundred thirty-three of the laws of nineteen hundred eighty, sections sixteen hundred three, sixteen hundred six, sixteen hundred seven and sixteen hundred twelve as amended and sections sixteen hundred nine, sixteen hundred ten, sixteen hundred eleven and sixteen hundred thirteen as added by chapter eight hundred ninety-four of the laws of nineteen hundred seventy-six, is amended to read as follows:

ARTICLE 16

SECURITY TAKEOVER DISCLOSURE ACT

§ 1600. Short title.

This article shall be known as the security takeover disclosure act.

§ 1601. [Regulations] Definitions.

As used in this article, the following terms shall have the following meanings:

(a) "Takeover bid" means the acquisition of or offer to acquire by an offeror from an offeree, pursuant to a tender offer or request [of] or invitation for tenders, any equity security of a target company [organized under the laws of this state or having its principal place of business and substantial assets within this state], if after acquisition thereof the offeror would, directly or indirectly, be a [record or] beneficial owner of more than five percent of any class of the issued and outstanding equity securities of such target company.

EXPLANATION--Matter underlined or in *italics* is new;

change Act on the effective date of such amendment, and which is a business combination with an interested shareholder whose stock acquisition date is prior to the effective date of such amendment; or § 2

(3) to any business combination of a resident domestic corporation (i) the original certificate of incorporation of which contains a provision expressly electing not to be governed by this section, or (ii) which adopts an amendment to such resident domestic corporation's by-laws prior to March thirty-first, nineteen hundred eighty-six, expressly electing not to be governed by this section, or (iii) which adopts an amendment to such resident domestic corporation's by-laws, approved by the affirmative vote of the holders, other than interested shareholders and their affiliates and associates, of a majority of the outstanding voting stock of such resident domestic corporation, excluding the voting stock of interested shareholders and their affiliates and associates, expressly electing not to be governed by this section, provided that such amendment to the by-laws shall not be effective until eighteen months after such vote of such resident domestic corporation's shareholders and shall not apply to any business combination of such resident domestic corporation with an interested shareholder whose stock acquisition date is on or prior to the effective date of such amendment; or

(4) to any business combination of a resident domestic corporation with an interested shareholder of such resident domestic corporation which became an interested shareholder inadvertently, if such interested shareholder (i) as soon as practicable, divests itself of a sufficient amount of the voting stock of such resident domestic corporation so that it no longer is the beneficial owner, directly or indirectly, of twenty percent or more of the outstanding voting stock of such resident domestic corporation, and (ii) would not at any time within the five-year period preceding the announcement date with respect to such business combination have been an interested shareholder but for such inadvertent acquisition.

(5) to any business combination with an interested shareholder who was the beneficial owner, directly or indirectly, of five per cent or more of the outstanding voting stock of such resident domestic corporation on October thirtieth, nineteen hundred eighty-five, and remained so to such interested shareholder's stock acquisition date.

§ 3. Legislative findings and declaration. The legislature finds that shareholders who reside in New York state should be provided with full and fair disclosure of all facts material to the making of an informed decision about takeover bids for New York state corporations having a significant nexus to this state. The legislature further finds that such disclosure includes information required by federal law, but also includes information that is of particular interest to shareholders who reside in this state in assessing the impact of a proposed takeover bid on the employees and communities that would be affected. The legislature further finds that the most effective means for insuring that such disclosures are made to New York state residents is to require the filing of disclosure statements with the attorney general and to grant the attorney general the authority to enforce compliance with the requirements of this statute. § 3

matter in brackets [ ] is old law to be deleted.

[(b) "Takeover bid"] Such term does not include: § 4

(1) Bids made by a dealer for his own account in the ordinary course of his business of buying and selling such security;

(2) An offer to acquire such equity security solely in exchange for other securities, or the acquisition of such equity security pursuant to such offer, for the sole account of the offeror, in good faith and not for the purpose of avoiding this section, and not involving any public offering of such other securities within the meaning of section four of title one of the "Securities Act of 1933", (48 Stat.77, 15 U.S.C. [77 D (2)] 77 d (2)); as amended;

(3) Any other offer to acquire an equity security, or the acquisition of such equity security pursuant to such offer, for the sole account of the offeror, from not more than fifty [persons] offerees, in good faith and not for the purpose of avoiding [this section] the provisions of this article;

(4) Any offer or class of offer [which the attorney general, by regulation or order, shall exempt from the definition of "takeover bid" as not being made for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purpose of this article] where, prior to making the offer, the offeror beneficially owns, directly or indirectly, a majority of the voting equity securities of the target company;

[(c)] (b). "Offeror" means a person who makes, or in any way participates or aids in making, a takeover bid, and includes persons acting jointly or in concert, or who intend to exercise jointly or in concert any voting rights attached to the securities for which such takeover bid is made. An "offeror" includes an issuer of securities whose securities are or are to be the subject of a takeover bid whether or not the issuer, upon acquisition, will become the beneficial owner of such securities. "An offeror" does not include any bank or broker-dealer in securities loaning funds to the offeror in the ordinary course of the business of the bank or broker-dealer in securities and not otherwise participating in the takeover bid, or any bank, broker-dealer in securities, attorney, accountant or consultant furnishing information or advice to an offeror and not otherwise participating in the takeover bid.

[(d)] (c) "Offeree" means the beneficial [or record] owner, residing in this state, of securities which an offeror acquires or offers to acquire in connection with a takeover bid.

[(e)] (d) "Target company" means [an issuer of securities whose securities are or are to be the subject of a takeover bid] a corporation, organized under the laws of this state and having its principal executive offices or significant business operations located within this state.

[(f)] (e) "Equity security" means any stock, bond, or other obligation of a target company, the holder of which has the right to vote for the election of members of the board of directors, or those exercising a similar function if the target company is not a corporation, of such target company. Equity security includes any security convertible into an equity security, and also includes any right, option or warrant to purchase an equity security.

matter in brackets [ ] is old law to be deleted.

§ 4 § 1602. [Requirement of financial disclosure] Disclosure requirement.
(a) No offeror shall make a takeover bid unless as soon as practicable on the date of commencement of the takeover bid he files with the attorney general at his New York city office and delivers to the target company at its principal executive offices a registration statement containing the information required by section sixteen hundred three of this article.

(b) An offeror shall make full and fair disclosure to offerees of the material information set forth in the registration statement filed pursuant to subdivision (a) of this section.

(c) No solicitation or recommendation to the offerees of a target company to accept or reject a takeover bid shall be made by or on behalf of an offeror or a target company unless at the time copies of such solicitation or recommendation are first published, sent or given to such offerees, the person making such solicitation or recommendation has filed copies of the solicitation or recommendation with the attorney general at his New York city office.

§ 1603. Contents of registration statement.
(a) The registration statement required to be filed pursuant to subdivision (a) of section sixteen hundred two of this article shall include:

1. Copies of all prospectuses, brochures, advertisements, circulars, letters, or other matter by means of which the offeror proposes to disclose to offerees all information material to a decision to accept or reject the offer;

2. The identity and background of all persons on whose behalf the acquisition of any equity security of the target company has been or is to be effected;

3. The exact title and number of shares outstanding of the class of equity securities being sought, the number of such securities being sought and the consideration being offered therefor;

4. The source and amount of funds or other consideration used or to be used in acquiring any equity security, including a statement describing any securities, other than the existing capital stock or long term debt of the offeror, which are being offered in exchange for the equity securities of the target company and also including copies of all loan or credit agreements and letters of commitment used or to be used to secure financing for the acquisition of any equity security of the target company;

[4] 5. A statement of any plans or proposals which the offeror, upon gaining control, may have to liquidate the target company, sell its assets, effect a merger or consolidation of it, or make any other major change in its business, corporate structure, management personnel, or policies of employment;

[5] 6. The number of shares of any equity security of the target company of which each offeror is beneficial or record owner or has a right to acquire, directly or indirectly, together with the name and address of each person defined in this section as an offeror;

EXPLANATION--Matter underlined or in *italics* is new;

[6] 7. Particulars as to any contracts, arrangements, or understandings to which an offeror is party with respect to any equity security of the target company, including without limitation transfers of any equity security, joint ventures, loans or option arrangements, puts and calls, guarantees of loan, guarantees against loss, guarantees of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into; § 4

[7] 8. Complete information on the organization and operations of the offeror, including without limitation the year of organization, form of organization, jurisdiction in which it is organized, a description of each class of the offeror's capital stock and of its long term debt, financial statements for the current period and for the three most recent annual accounting periods, a description of pending legal proceedings other than routine litigation to which the offeror or any of its subsidiaries is a party or of which any of their property is the subject, a brief description of the business done and projected by the offeror and its subsidiaries and the general development of such business over the past five years, the names of all directors and executive officers together with biographical summaries of each for the preceding three years to date; [and

8. Such other and further documents, exhibits, data and information as may be required by the attorney general]

9. A statement as to the potential impact, if any, of the offeror's plans or proposals on the residents of New York state, including any material change in the location of the target company's offices or business activities within this state; any plant or facility relocation; any plant or facility closings; any significant reduction in the workforce at an individual plant or facility; any other material change in the number, job classification, compensation, or other terms and conditions of employment of persons employed by the target company in this state; any material change in the relationships of the target company with suppliers or customers within this state, or any other material changes in the target company's business, corporate structure, management, personnel or activities which would have a substantial impact on residents of this state;

10. Particulars as to any pension plans; profit sharing plans; savings plans; educational opportunities; relocation adjustments; labor relations records, including violations of the federal national labor relations act, occupational safety and health act of 1970, fair labor standards act, or employee retirement and income security act, as amended, finally adjudicated or settled within five years of the commencement of the takover bid; earnings and dividend growth; community activities; and charitable, cultural, educational and civic contributions of the offeror;

11. If the offeror is a natural person, information concerning his identity and background, including without limitation financial statements for the current and three preceding years, a description of his business activities and affiliations during that time period, and a

matter in brackets [ ] is old law to be deleted.

§ 4 description of any pending legal or administrative proceedings, other than routine and immaterial litigation, to which the offeror is a party or of which any of his property is the subject; and

12. If debt securities or preferred stock are either offered in the takeover bid or used as a source of funds in making the takeover bid, the investment rating, if any, by a generally recognized rating service of such debt security or preferred stock.

(b) If any material change occurs in the facts set forth in the registration statement required by subdivision (a) of section sixteen hundred two of this article, the offeror who filed such statement shall promptly notify the attorney general and the target company of such change in writing or by telephone confirmed in writing and shall amend the registration statement to reflect such change [within ten days of the change.

§ 1604. Scheduling of public hearing.

Within fifteen days of the filing of a registration statement pursuant to section sixteen hundred two the attorney general may schedule a public hearing or hearings or conduct such investigation as he deems necessary concerning any takeover bid for the purpose of determining compliance with the requirements of this article, and whether the offeror has provided full and fair disclosure to offerees of all material information concerning the takeover bid including the filing of a complete and accurate registration statement. Any initial hearing shall commence within twenty-five days of the filing of a registration statement.

§ 1605. Prohibition of takeover bid.

(a) In the event the attorney general shall schedule a public hearing or hearings or otherwise conduct an investigation, pursuant to section sixteen hundred four, the attorney general may also, in his discretion, issue an order prohibiting an offeror from purchasing or paying for any shares tendered in response to its takeover bid at any time prior to such purchasing or paying for shares tendered but in no event longer than fifty-five days after the filing of the registration statement. Every person shall comply with every such order.

(b) Any order issued by the attorney general pursuant to subdivision (a) of this section prohibiting an offeror from purchasing or paying for any shares tendered in response to its takeover bid shall automatically expire unless within thirty days of the completion of a hearing or hearings held pursuant to section sixteen hundred four, or the conclusion of his investigation conducted pursuant to such section, or fifty-five days after the filing of the registration statement whichever is sooner, the attorney general shall determine that the requirements of this article have not been met, and shall have issued an order containing his findings of fact and conclusions of law prohibiting the purchase and payment for any shares tendered in response to the takeover bid or conditioning any such purchase and payment upon changes or modifications in the registration statement] promptly but not later than the date such change is first published, sent or given to offerees.

EXPLANATION—Matter underlined or in *italics* is new;

(c) The attorney general may permit the omission of any information required by subdivision (a) of this section to be included in the registration statement if he determines that such information is immaterial or otherwise unnecessary for the protection of offerees. § 4

§ [1606] 1604. Enforcement.

(a) The attorney general may conduct such investigation as he deems necessary concerning any takeover bid for the purpose of determining compliance with the requirements of this article. As part of such investigation the attorney general may require persons to file statements in writing and under oath with his office, subpoena witnesses, compel their attendance, examine them under oath and require the production of books, records, documents and papers.

(b) In the event the attorney general determines that any person is violating or about to violate any provision of this article, or any order, rule or regulation issued pursuant thereto, he may seek [an injunction], in a court of competent jurisdiction, an injunction temporarily or permanently barring that person from making or taking part in or continuing a takeover bid or from taking up or paying for shares tendered by offerees pursuant to a takeover bid, and the court may grant the relief applied for or so much thereof as it may deem proper.

[(b) In administering and enforcing the provisions of this act, the attorney general shall possess all the powers granted to his office pursuant to the provisions of article twenty-three-A of the general business law, including, but in no manner limited to, the power to:

1. conduct any investigation;

2. require persons to file statements in writing and under oath with his office;

3. require and receive such data and information as he may deem relevant; and

4. subpoena witnesses, compel their attendance, examine them under oath and require the production of books, records or papers.]

§ [1607] 1605. Violations; penalties.

(a) Every person who willfully violates any provision of this article[, or] shall be guilty of a class E felony; every person who willfully violates any order, rule or regulation issued pursuant thereto, shall be guilty of a class A misdemeanor.

(b) A violation of any provision of this article shall constitute a fraudulent practice within the meaning of article twenty-three-A of the general business law.

(c) Every person who violates any provision of this article shall be subject to a civil penalty of one thousand dollars per violation if a natural person or ten thousand dollars per violation if a corporation. When the violation is the failure to file a registration statement as required by subdivision (a) of section sixteen hundred two of this article, the failure to file a solicitation or recommendation as required by subdivision (c) of section sixteen hundred two of this article, or the failure to amend such registration statement as required by subdivision (b) of section sixteen hundred three of this article, each business day of non-registration or failure to file a recommendation or solicitation

matter in brackets [ ] is old law to be deleted.

§ 4 or failure to amend constitutes a separate violation. The penalty imposed by this section shall be cumulative and more than one penalty shall be recoverable in the same action in any court of competent jurisdiction.

§ [1608] 1606. Administration.

(a) This article shall be administered by the attorney general and employees designated by him within the department of law. The attorney general is hereby empowered to promulgate, alter, amend or revoke rules and regulations necessary to carry out the purposes of this article.

(b) The attorney general may establish fees for the filing of any registration statement, not to exceed two thousand five hundred dollars, to recover the costs of administering this article. Such fees may vary according to the maximum consideration payable by the offeror for the securities which are the subject of the takeover bid.

§ [1609] 1607. Prosecutions and immunity.

(a) The attorney general may prosecute every person charged with the commission of a criminal offense arising from the violation of any provision of this article. In all such proceedings, the attorney general may appear in person or by his deputy before any court of record or any grand jury and exercise all the powers and perform all the duties in respect of such actions or proceedings which the district attorney would otherwise be authorized or required to exercise or perform; or the attorney general may in his discretion transmit evidence, proof and information as to such offense to the district attorney of the county or counties in which the alleged violation has occurred, and every district attorney to whom such evidence, proof and information is so transmitted shall forthwith proceed to prosecute any corporation, company, association, or officer, manager or agent thereof, or any firm or person charged with such violation. In any such proceeding, wherein the attorney general has appeared either in person or by deputy, the district attorney shall only exercise such powers and perform such duties as are required of him by the attorney general or the deputy attorney general so appearing.

(b) Upon any investigation before the attorney general or his deputy or other officer designated by him, or in any criminal proceeding before any court, magistrate or grand jury, pursuant to or for a violation of any of the provisions of this article, the attorney general, his deputy or other officer designated by him, or the court, magistrate or grand jury, may confer immunity in accordance with the provisions of section 50.20 of the criminal procedure law.

§ [1610] 1608. Designation of secretary of state for service.

(a) Every nonresident offeror, whether or not such offeror has filed a registration statement, except a foreign corporation which has appointed and keeps a resident agent in this state, shall be deemed to have appointed the secretary of state as his agent upon whom may be served any lawful process, authorized by this article, with the same effect as though served upon the offeror personally.

(b) Service of process pursuant to this section shall be accomplished by leaving a copy of the process in the office of the secretary of

EXPLANATION--Matter underlined or in *italics* is new;

state, but it shall not be effective unless notice of the service and a copy of the process is sent by certified or registered mail to the non-resident offeror served, at his last known address. § 4

§ [1611] 1609. Fraudulent, deceptive or manipulative practices.

(a) No person shall make any untrue statement of a material fact or omit to state any material fact necessary in order to make the [statement] statements made, in the light of the circumstances under which they are made, not misleading, or [to] engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any [tender offer or request or invitation for tenders,] takeover bid or any solicitation of [security holders] offerees in opposition to or in favor of any such [offer, request, or invitation] takeover bid. [A violation of this section shall be a class A misdemeanor.]

(b) It shall constitute a violation of this article for any person who is in possession of material information relating to any takeover bid, which information he knows or has reason to know is nonpublic, which he acquired either before or after the commencement of the takeover bid, and which he knows or has reason to know has been acquired directly or indirectly from an offeror, a target company, or any officer, director, partner or employee or any other person acting on behalf of the offeror or target company, to purchase or sell or cause to be purchased or sold, within or from this state, any securities sought or to be sought by such takeover bid or any securities convertible into or exhangeable for any such securities or any option or right to obtain or to dispose of any such securities.

(c) Fraudulent, deceptive or manipulative acts or practices include without limitation those acts and practices proscribed by rules and regulations which the attorney general is hereby empowered to adopt, promulgate, amend and rescind as is necessary to carry out the provisions of this section.

§ [1612] 1610. Exclusions.

This article shall not apply when:

(a) The offeror or the target company is a public utility or a public utility holding company as defined in section two of the "Public Utility Holding Company Act of 1935," (49 Stat. 803, 15 U.S.C. 79), as amended, and the takeover bid is subject to approval by the appropriate federal agency as provided in such act;

(b) The offeror or the target company is a bank or a bank holding company as subject to the "Bank Holding Company Act of 1956," (70 Stat. 133, 12 U.S.C. 1841), and subsequent amendments thereto, and the takeover bid is subject to approval by the appropriate federal agency as provided in such act;

(c) The offeror or the target company is a savings and loan holding company as defined in section two of the "Savings and Loan Holding Company Amendments of 1967," (82 Stat. 5, 12 U.S.C. 1730A), as amended, and the takeover bid is subject to approval by the appropriate federal agency as provided in such act;

(d) The offeror and the target company are banks and the offer is part of a merger transaction subject to approval by appropriate federal or state supervisory authorities.

matter in brackets [ ] is old law to be deleted.

§ 4 § [1613] 1611. Validity; saving clause.

In the event any provision or application of this article shall be held illegal or invalid for any reason, such holding shall not affect the legality or validity of any other provision or application thereof.

[§ 1614. Filings with sister states.

The attorney general, upon application made to him or upon his own initiative, in his sole discretion, may waive the filing of a registration statement as required by section sixteen hundred two of this article in connection with any takeover bid (other than a takeover bid with respect to a target company organized under the laws of this state) when it appears to him that (i) the takeover bid is subject to the jurisdiction of a state (or the District of Columbia) having a statute or regulation similar in effect to this article; (ii) such statute or regulation, or the state official, commission or other such body empowered by such statute or regulation and acting pursuant to such statute or regulation, has required the filing, by the offeror, of a registration statement, or other similar document, in connection with the takeover bid; (iii) such state (or the District of Columbia) has a greater interest in regulating the takeover bid than this state, and (iv) the purposes of this article will be accomplished by such waiver.]

§ 1612. Requirements for certain takeover bids.

If the takeover bid is not subject to the requirements of section 14(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d), the following additional requirements shall apply to the takeover bid:

(a) The takeover bid shall be made on the same terms to all offerees holding the same class or series of securities.

(b) The period of time within which equity securities may be deposited pursuant to a takeover bid shall not be less than thirty business days.

(c) Equity securities deposited pursuant to a takeover bid may be withdrawn at any time until the expiration of thirty business days after the commencement of the takeover bid and at any time after the expiration of sixty-five days from the commencement of the takeover bid, if the shares have not been purchased, and until the expiration of ten business days following the date of commencement of another offeror's takeover bid for the same equity securities if the shares have not been purchased and if the bidder has received notice or otherwise has knowledge of the commencement of such takeover bid.

(d) Where a takeover bid is made for less than all the outstanding equity securities of a class and where a greater number of such securities is deposited pursuant thereto than the offeror is bound or willing to take up and pay for, the securities taken up and paid for by the offeror shall be taken up and paid for as nearly as possible on a pro rata basis, disregarding fractions, according to the number of securities deposited by each shareholder.

(e) Where an offeror increases the consideration offered in a takeover bid, the offeror shall pay the increased consideration for all equity securities accepted, whether such securities have been accepted by the offeror before or after the increase in consideration.

(f) (1) Within ten days of the filing of a registration statement as required by section sixteen hundred two of this article the attorney general may schedule a public hearing or hearings or conduct such investigation as he deems necessary concerning any takeover bid for the purpose of determining compliance with the requirements of this article; § 4

(2) Any such hearing or investigation shall be declared by order of the attorney general;

(3) Any initial hearing shall commence within twenty days of the filing of a registration statement.

(g) In the event the attorney general shall schedule a public hearing or otherwise conduct an investigation pursuant to subdivision (f) of this section, the attorney general may also, in his discretion, issue an order staying the offeror from purchasing or paying for any shares tendered in response to its takeover bid at any time prior to such purchasing or paying for shares tendered. Every person shall comply with every such order.

(h) In the event the attorney general shall issue a stay payment order pursuant to subdivision (g) of this section, the attorney general shall, no later than thirty days from the issuance of such stay payment order, issue an order containing his findings of fact and conclusions of law.

(i) Any stay payment order issued by the attorney general pursuant to subdivision (g) of this section shall automatically expire within sixty days from its issuance except where the attorney general has in his order containing findings of fact and conclusions of law conditioned the purchase and payment for shares tendered upon changes or modifications in the registration statement, in which event any stay payment order shall be vacated by the attorney general after he is satisfied that such changes or modifications have been publicly disseminated to offerees.

(j) The attorney general may apply, on notice to the offeror and the target company, to a court of competent jurisdiction, and such court may grant an application, for good cause, to extend any of the time periods set forth in this section if an extension is necessary for the protection of offerees.

§ 1613. Private right of action.

Any offeree whose equity securities are the subject of a takeover bid and who has been injured by any violation of this article may bring an action in his or her own name to enjoin such unlawful act or practice and to recover actual damages together with reasonable attorney fees in the event the offeree is successful.

§ 5. Severability. If any clause, sentence, paragraph, section or part of this act shall be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, section, or part thereof directly involved in the controversy in which such judgment shall have been rendered. § 5

§ 6. This act shall take effect immediately, except that sections one, three and four of this act shall take effect on the sixtieth day after it shall have become a law, provided however, that sections three and § 6

matter in brackets [ ] is old law to be deleted.

§ 6 four shall not apply to any takeover bid in which a tender offer or request or invitation for tenders has been published or sent or given to offerees prior to such effective date; provided further, that effective immediately, the addition, amendment and/or repeal of any rules or regulations necessary for the implementation of section four of this act on its effective date are authorized and directed to be made and completed on or before such effective date.

Chapter 916

MOTOR VEHICLE INSURANCE--COMPETITIVE RATING REQUIREMENTS--

EXCESS PROFITS--EXTENSION OF TIME

AN ACT to amend the insurance law, in relation to extending the period of duration of the excess profits provisions applicable to motor vehicle insurance, and extending the period of duration of the effectiveness of certain provisions relating to competitive rating requirements and other provisions of article twenty-three of such law

Approved and effective December 20, 1985.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

§ 1 Section 1. Subsection (f) of section two thousand three hundred five of the insurance law is amended to read as follows:

(f) Subsection (a) hereof shall be of no force or effect after [December thirty-first] May fifteenth, nineteen hundred [eighty-five] eighty-six. Commencing [January first] May sixteenth, nineteen hundred eighty-six, all rates previously subject to subsection (a) hereof, other than rates which are not required to be filed pursuant to subsection (b) of section two thousand three hundred ten of this article or which have been suspended from the filing requirement pursuant to section two thousand three hundred eleven of this article, shall become subject to subsections (b), (c) and (d) hereof. All other provisions of this article applicable to kinds of insurance or insurance activities the rates for which are subject to prior approval under subsection (b) hereof shall apply to kinds of insurance the rates for which were previously subject to subsection (a) hereof or the rates for which are not required

EXPLANATION--Matter underlined or in *italics* is new;

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MICHAEL S. DUKAKIS
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JOSEPH D. ALVIANI
SECRETARY

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M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani

DATE: August 8, 1988

RE: CONNECTICUT - PENDING BUSINESS COMBINATION BILL

This memo is designed to provide a brief overview of the pending Connecticut business combination bill (S. 535). Although similar to Delaware in some respects, S. 535 provides an interesting example of how a business combination statute could be used to address other concerns raised by the Commission such as the effect board composition has on efficiency; the fiduciary duty of corporate directors; and the provision of "soft landing" benefits to stakeholders dislocated as the result of a change in corporate control. This memo is intended only as an aid to discussion; all comments and criticisms would be deeply appreciated.

How it works

The business combination statute currently being considered by the Connecticut Legislature (S. 535) closely resembles New York's. If a person acquires 10% or more of the voting stock of a Connecticut corporation without prior board approval, he becomes an "interested shareholder" and may not engage in any "business combination" with the corporation for five years, <u>unless</u>:

(a) the corporation has opted out of coverage before the business combination or purchase of shares was proposed.

(b) a person becomes an interested shareholder inadvertently and divests himself as soon as practicable.

(c) a person becomes an interested shareholder because he owned 10% or more on February 1, 1988.

(d) the target corporation is a signatory to the Connecticut Partnership Compact and amends it charter or by-laws by a 2/3 shareholder vote to opt out of coverage, effective 18 months following the vote.

S. 535 provides only one way to avoid the business combination prohibition if one of the above exceptions does not apply. The buyer must obtain board approval of the stock acquisition that would push him over the 10% threshold or of the proposed business combination before he becomes an interested shareholder. This requires the approval of a majority of the board as a whole and of the outside directors as well of which there must be two. S. 535 specifically states that the fiduciary duty of directors evaluating an offer permits them to consider the interests of stakeholders and the possibility that the interests of the corporation and its shareholders may be best served by refusing the offer.

To summarize, S. 535 appears to be a more stringent version of the Delaware model with three additional differences:

1. It would establish a minimum number of outside directors for the boards of Connecticut corporations seeking to opt out of its coverage after the business combination prohibition has been triggered.

2. It would require that a corporation seeking to opt out after triggering the statute be a signatory to the Connecticut Partnership Compact and wait 18 months after receiving shareholder approval.

3. It explicitly states that a director may consider the interests of corporate stakeholders and the community in evaluating whether to accept/reject an offer.

General effect

Like all business combination statutes, S. 535 would presumably encourage bidders to negotiate directly with the board rather than attempting to acquire control through stock purchases. Since prior approval is the only way to avoid triggering the business combination prohibition S. 535 would appear to be a strong incentive to negotiating with the board. It is less clear that the Connecticut provides as strong an incentive as Delaware for making a fully financed any and all offer since even if an interested shareholder had 100% control, replaced the board and had it sign the Compact and opt out, it would still have to wait 18 months before engaging in a business combination. Like Delaware, however, the option of a proxy contest remains to transfer control prior to proposing a business combination or crossing the 10% threshold. The overall effect of the "Compact/opt out" provision would appear to be that of providing at

least 18 months notice prior to consummation of a business combination following an unsolicited bid or stock purchase triggering the 10% threshold.

What S. 535 does not do, but easily could have done, is make application of the business combination prohibition conditional on either the "interested shareholder" or the target corporation becoming a signatory of the Compact. This would be mechanism similar to that proposed by Professor Reich, depending on the Compact's terms and conditions. The most important variable in this context would be who should be the signatory? Requiring the "raider" to be a signatory could raise the transaction cost and either deter marginal buyers or create incentives for target asset sell-offs once the transaction is completed. Encouraging the Connecticut firm to be the signatory would probably have the most direct effect in the short-term on worker and community dislocation (again, depending on the terms the Compact). While this might provide the greatest protection, requiring firms to sign the Compact, if it is to have meaning, would almost certainly require them to divert funds into "reserve accounts" of some type to pay severance benefits. This could slow growth dependent on investment in R & D, equipment, marketing and training. There is considerable debate whether this type of response promotes or hinders long-term economic growth. The argument in support is generally that it increases the stake in making an operation competitive in the long-run since it greatly increases the costs of going out of business. The opposing argument is that it introduces rigidities and barriers to change just at a time of economic transition that requires maximum flexibility.

Substitute Senate Bill No. 535

PUBLIC ACT NO. 88-350

AN ACT CONCERNING APPROVAL OF CERTAIN BUSINESS COMBINATIONS.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. (NEW) For the purposes of sections 1 to 3, inclusive, of this act:

(1) "Affiliate" means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, a specified person.

(2) "Announcement date", when used in reference to any business combination, means the date of the first public announcement of the final, definitive proposal for such business combination.

(3) "Associate", when used to indicate a relationship with any person, means (A) any corporation or organization of which such person is an officer or partner or is, directly or indirectly, the beneficial owner of ten per cent or more of any class of voting stock, (B) any trust or other estate in which such person has at least a ten per cent beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (C) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person.

(4) "Beneficial owner", when used with respect to any voting stock, means a person:

(A) That, individually or with or through any of its affiliates or associates, beneficially owns such stock, directly or indirectly;

(B) That, individually or with or through any of its affiliates or associates, has (i) the right to acquire such stock, whether such right is exercisable immediately or only after the passage of time or upon the occurrence of a specified event, pursuant to any agreement, arrangement or understanding whether or not in writing, or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise; provided, a person shall not be deemed the beneficial owner of stock tendered pursuant to a tender or exchange offer made by such person or any of such person's affiliates or associates until such tendered stock is accepted for purchase

or exchange; (ii) the right to vote such stock pursuant to any agreement, arrangement or understanding whether or not in writing; provided, a person shall not be deemed the beneficial owner of any stock under this subparagraph if the agreement, arrangement or understanding to vote such stock arises solely from a revocable proxy or consent given in response to a proxy or consent solicitation made in accordance with the applicable rules and regulations under the Exchange Act and is not then reportable on Schedule 13D under the Exchange Act or any comparable or successor report; or (iii) the right to dispose of such stock pursuant to any agreement, arrangement or understanding whether or not in writing; or

(C) That, individually or with or through any of its affiliates or associates, has any agreement, arrangement or understanding whether or not in writing for the purpose of acquiring, except pursuant to a tender or exchange offer until such tendered stock is accepted for purchase or exchange as described in subparagraph (B)(i) of this subdivision, holding, voting, except voting pursuant to a revocable proxy or consent as described in subparagraph (B)(ii) of this subdivision, or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

(5) "Business combination", when used in reference to any resident domestic corporation and any interested shareholder of such resident domestic corporation, means:

(A) Any merger or consolidation of such resident domestic corporation or any subsidiary of such resident domestic corporation with or into (i) such interested shareholder or (ii) any other corporation whether or not itself an interested shareholder of such resident domestic corporation which is, or after such merger or consolidation would be, an affiliate or associate of such interested shareholder;

(B) Any sale, lease, exchange, mortgage, pledge, transfer or other disposition in one transaction or a series of transactions to or with such interested shareholder or any affiliate or associate of such interested shareholder of assets of such resident domestic corporation or any subsidiary of such resident domestic corporation (i) having an aggregate market value equal to ten

per cent or more of the aggregate market value of all the assets, determined on a consolidated basis, of such resident domestic corporation, (ii) having an aggregate market value equal to ten per cent or more of the aggregate market value of all the outstanding stock of such resident domestic corporation, or (iii) representing ten per cent or more of the earning power or net income, determined on a consolidated basis, of such resident domestic corporation, except pursuant to a dividend or distribution paid or made pro rata to all holders of common stock of such resident domestic corporation and to all holders of any other class of stock of such resident domestic corporation entitled to participate with the holders of common stock in the receipt of such dividend or distribution;

(C) The issuance or transfer by such resident domestic corporation or any subsidiary of such resident domestic corporation in one transaction or a series of transactions of any stock of such resident domestic corporation or any subsidiary of such resident domestic corporation which has an aggregate market value equal to five per cent or more of the aggregate market value of all the outstanding stock of such resident domestic corporation to such interested shareholder or any affiliate or associate of such interested shareholder, except (i) pursuant to a dividend or distribution paid or made pro rata to all holders of common stock of such resident domestic corporation and to all holders of any other class of stock of such resident domestic corporation entitled to participate with the holders of common stock in the receipt of such dividend or distribution, or (ii) pursuant to the exercise of warrants or rights to purchase stock or pursuant to the conversion of convertible securities;

(D) The adoption of any plan or proposal for the complete or partial liquidation or dissolution of such resident domestic corporation or any subsidiary of such resident domestic corporation, or declarations or payments of dividends and distributions to the holders of stock of such resident domestic corporation in any twelve-month period having an aggregate market value of more than five per cent of the aggregate market value of all assets, determined on a consolidated basis, of such resident domestic corporation as of the beginning of such twelve-month period, which plan or proposal is, or declarations or payments are,

proposed by, or pursuant to any agreement, arrangement or understanding whether or not in writing with, such interested shareholder or any affiliate or associate of such interested shareholder, at any time following such interested shareholder's stock acquisition date;

(E) Any reclassification of securities including, without limitation, any stock split, stock dividend, or other distribution of stock in respect of stock, or any reverse stock split, or recapitalization of such resident domestic corporation, or any merger or consolidation of such resident domestic corporation with any subsidiary of such resident domestic corporation, or any other transaction whether or not with or into or otherwise involving such interested shareholder, which reclassification, merger, consolidation or other transaction (i) has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class or series of voting stock or securities convertible into voting stock of such resident domestic corporation or any subsidiary of such resident domestic corporation which is directly or indirectly owned by such interested shareholder or any affiliate or associate of such interested shareholder, except as a result of immaterial changes due to fractional share adjustments, and (ii) is proposed by, or pursuant to any agreement, arrangement or understanding whether or not in writing with, such interested shareholder or any affiliate or associate of such interested shareholder at any time following such interested shareholder's stock acquisition date; or

(F) Any receipt by such interested shareholder or any affiliate or associate of such interested shareholder of the benefit, directly or indirectly, except proportionately as a shareholder of such resident domestic corporation, of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by or through such resident domestic corporation or any subsidiary of such resident domestic corporation; provided, for purposes of subparagraphs (A), (B) and (C) of this subdivision, a corporation, hereinafter referred to as the "other corporation", which has entered into a definitive agreement or an agreement in principle or has an arrangement or understanding, whether formal or informal, in writing or not, with such resident domestic corporation or any

subsidiary of such resident domestic corporation providing for any of the transactions contemplated by subparagraphs (A), (B) and (C) of this subdivision between such resident domestic corporation or any subsidiary of such resident domestic corporation and the other corporation or any subsidiary of the other corporation shall not be deemed to be an associate of such interested shareholder solely by reason of the fact that, after the date of such definitive agreement or agreement in principle or arrangement or understanding or the date of the first public announcement or disclosure of such transaction, whichever is earlier, such interested shareholder becomes, or after such transaction would become, directly or indirectly, the beneficial owner of ten per cent or more of any class of voting stock of the other corporation.

(6) "Control", including the terms "controlling", "controlled by" and "under common control with", means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise. A person's beneficial ownership of ten per cent or more of the voting power of a corporation's outstanding voting stock shall create a presumption that such person has control of such corporation. Notwithstanding the foregoing, a presumption of control shall not apply where such person holds voting stock, in good faith and not for the purpose of circumventing sections 1 to 3, inclusive, of this act, as an agent, bank, broker, nominee, custodian or trustee for one or more beneficial owners who do not individually or as a group have control of such corporation.

(7) "Corporation" means any corporation, whether domestic or foreign.

(8) "Exchange Act" means the Act of Congress known as the Securities Exchange Act of 1934, as the same has been or hereafter may be amended from time to time.

(9) "Interested shareholder", when used in reference to any resident domestic corporation, means any person, other than such resident domestic corporation or any subsidiary of such resident domestic corporation, that: (A) Is the beneficial owner, directly or indirectly, of ten per cent or more of the voting power of the outstanding voting stock of such resident domestic

corporation or (B) is an affiliate or associate of such resident domestic corporation and at any time within the five-year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of ten per cent or more of the voting power of the then outstanding voting stock of such resident domestic corporation; provided for the purpose of determining whether a person is an interested shareholder, the number of shares of voting stock of such resident domestic corporation deemed to be outstanding shall include shares deemed to be beneficially owned by the person but shall not include any other unissued shares of voting stock of such resident domestic corporation which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

(10) "Person" means a natural person, company, partnership, foreign or domestic corporation, trust, unincorporated organization, government or any other entity or political subdivision, agency or instrumentality of a government. The term also includes two or more of the foregoing acting as a partnership, limited partnership, syndicate, joint venture or other formal or informal group for the purpose of acquiring, holding, voting or disposing of securities of an issuer.

(11) "Resident domestic corporation" means an issuer of voting stock which: (A) Is organized under the laws of this state and (B) has its principal executive offices or significant business operations located in this state or has a significant financial relationship with one or more businesses located in this state; provided no resident domestic corporation shall cease to be a resident domestic corporation by reason of events occurring or actions taken while such resident domestic corporation is subject to the provisions of sections 1 to 3, inclusive, of this act.

(12) "Stock" means:

(A) Any stock or similar security, any certificate of interest, any participation in any profit sharing agreement, any voting trust certificate, or any certificate of deposit for stock; and

(B) Any security convertible, with or without consideration, into stock, or any warrant, call or other option or privilege of buying stock without being bound to do so, or any other security

carrying any right to acquire, subscribe to or purchase stock.

(13) "Stock acquisition date", with respect to any person and any resident domestic corporation, means the date that such person first becomes an interested shareholder of such resident domestic corporation.

(14) "Subsidiary" of any resident domestic corporation means any other corporation of which voting stock, having a majority of the voting power of the outstanding voting stock of such other corporation, is owned, directly or indirectly, by such resident domestic corporation.

(15) "Voting stock" means shares of capital stock of a corporation entitled to vote generally in the election of directors.

Sec. 2. (NEW) (a) Except as provided in section 3 of this act, notwithstanding anything to the contrary in chapter 599 of the general statutes, no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date unless such business combination or the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date is approved by the board of directors of such resident domestic corporation and by a majority of the nonemployee directors of which there shall be at least two, prior to such interested shareholder's stock acquisition date.

(b) If a good faith proposal is made in writing to the board of directors of a resident domestic corporation regarding a business combination, the board of directors shall respond, in writing, within forty-five days or such shorter period, if any, as may be required by the Exchange Act, setting forth its reasons for its decision regarding such proposal. If a good faith proposal to purchase stock is made in writing to the board of directors of a resident domestic corporation, the board of directors, unless it responds affirmatively in writing within forty-five days or such shorter period, if any, as may be required by the Exchange Act, shall be deemed to have disapproved such stock purchase.

(c) The provisions of this section shall be in addition to any other provisions of the general statutes which apply to such business combination.

Sec. 3. (NEW) The provisions of section 2 of this act shall not apply:

(1) To any business combination between an interested shareholder or any affiliate or associate of such interested shareholder and a resident domestic corporation which does not have a class of voting stock registered pursuant to Section 12 of the Exchange Act on such interested shareholder's stock acquisition date, unless (A) the certificate of incorporation of such resident domestic corporation provides at the time of such business combination that the provisions of section 2 of this act shall apply or (B) the failure of such resident domestic corporation to have a class of voting stock registered pursuant to Section 12 of the Exchange Act results from the transaction in which such interested shareholder became an interested shareholder;

(2) To any business combination of a resident domestic corporation with an interested shareholder of such resident domestic corporation which became an interested shareholder inadvertently, if such interested shareholder (A) as soon as practicable, divests itself of a sufficient amount of the voting stock of such resident domestic corporation so that it no longer is the beneficial owner, directly or indirectly, of ten per cent or more of the outstanding voting stock of such resident domestic corporation, and (B) would not at any time within the five-year period preceding the announcement date with respect to such business combination have been an interested shareholder but for such inadvertent acquisition;

(3) To any business combination of a resident domestic corporation with an interested shareholder which was an interested shareholder on February 1, 1988, unless subsequent to the effective date of this act such interested shareholder increases its proportionate share of the voting power of the outstanding voting stock of such resident domestic corporation, excluding any increase approved by the board of directors of the resident domestic corporation before such increase occurs; or

(4) To any business combination of a resident domestic corporation which (A) on and after July 1, 1989, is a signatory to, and agrees to the standards contained in, the Connecticut Partnership Compact adopted pursuant to section 6 of this act and (B) adopts an amendment to such

resident domestic corporation's certificate of incorporation or bylaws which, in addition to any other approval required by law or by the certificate of incorporation or bylaws as applicable, is approved by the affirmative vote of the holders, other than interested shareholders and their affiliates and associates, of two-thirds of the voting power of the outstanding voting stock of such resident domestic corporation, excluding the voting stock of interested shareholders and their affiliates and associates, expressly electing not to be governed by the provisions of section 2 of this act, provided such amendment to the certificate of incorporation or bylaws shall not be effective until eighteen months after such vote of such resident domestic corporation's shareholders and shall not apply to any business combination of such resident domestic corporation with an interested shareholder whose stock acquisition date is on or prior to the effective date of such amendment.

Sec. 4. Section 33-313 of the general statutes is repealed and the following is substituted in lieu thereof:

(a) Subject to any provisions pertaining thereto contained in the certificate of incorporation, the business, property and affairs of a corporation shall be managed by or under the direction of its board of directors.

(b) No limitation upon the authority which the board of directors would have in the absence of such limitation shall be effective against persons without actual knowledge of such limitation, other than shareholders and directors.

(c) The board of directors shall have authority to fix fees of directors, including reasonable allowance for expenses actually incurred in connection with their duties, unless otherwise provided in the bylaws.

(d) A director shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care as an ordinarily prudent person in a like position would use under similar circumstances. In performing his duties, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by (1) one or more officers

or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented, (2) counsel, public accountants or other persons as to matters which the director reasonably believes to be within such person's professional or expert competence, or (3) a committee of the board upon which he does not serve, duly designated in accordance with a provision of the certificate of incorporation or the bylaws, as to matters within its designated authority, which committee the director reasonably believes to merit confidence, but he shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that causes such reliance to be unwarranted. A person who performs his duties in accordance with this subsection shall be presumed to have no liability by reason of being or having been a director of the corporation.

(e) FOR PURPOSES OF SECTIONS 33-364, 33-365 AND 33-371, SECTION 33-372 INSOFAR AS IT RELATES TO THE SALE OF ALL OR SUBSTANTIALLY ALL OF THE ASSETS OF A CORPORATION WHETHER OR NOT IN THE USUAL AND REGULAR COURSE OF BUSINESS OF THE CORPORATION, SECTION 33-374b AND SECTION 2 OF THIS ACT, A DIRECTOR OF A CORPORATION WHICH HAS A CLASS OF VOTING STOCK REGISTERED PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934, AS THE SAME HAS BEEN OR HEREAFTER MAY BE AMENDED FROM TIME TO TIME, IN ADDITION TO COMPLYING WITH THE PROVISIONS OF SUBSECTION (d) OF THIS SECTION, SHALL CONSIDER, IN DETERMINING WHAT HE REASONABLY BELIEVES TO BE IN THE BEST INTERESTS OF THE CORPORATION, (1) THE LONG-TERM AS WELL AS THE SHORT-TERM INTERESTS OF THE CORPORATION, (2) THE INTERESTS OF THE SHAREHOLDERS, LONG-TERM AS WELL AS SHORT-TERM, INCLUDING THE POSSIBILITY THAT THOSE INTERESTS MAY BE BEST SERVED BY THE CONTINUED INDEPENDENCE OF THE CORPORATION, (3) THE INTERESTS OF THE CORPORATION'S EMPLOYEES, CUSTOMERS, CREDITORS AND SUPPLIERS, AND (4) COMMUNITY AND SOCIETAL CONSIDERATIONS INCLUDING THOSE OF ANY COMMUNITY IN WHICH ANY OFFICE OR OTHER FACILITY OF THE CORPORATION IS LOCATED. A DIRECTOR MAY ALSO IN HIS DISCRETION CONSIDER ANY OTHER FACTORS HE REASONABLY CONSIDERS APPROPRIATE IN DETERMINING WHAT HE REASONABLY BELIEVES TO BE IN THE BEST INTERESTS OF THE CORPORATION. A PERSON WHO PERFORMS HIS DUTIES IN ACCORDANCE WITH THIS SUBSECTION SHALL BE DEEMED TO HAVE NO

LIABILITY BY REASON OF BEING OR HAVING BEEN A DIRECTOR OF THE CORPORATION.

Sec. 5. Section 33-326 of the general statutes is repealed and the following is substituted in lieu thereof:

(a) Meetings of shareholders shall be held at such place, either within or without this state, as may be designated by or determined in the manner provided in the bylaws, or, if not so designated or determined, at the principal office of the corporation in this state.

(b) An annual meeting of the shareholders shall be held at such time as may be designated by or determined in the manner provided in the bylaws or, if not so designated or determined, on the second Tuesday in February or, if such day is a legal holiday, the next following business day.

(c) Special meetings of the shareholders may be called ONLY by the [president, by the] board of directors, or by such [other officers] PERSON or persons as may be [provided in] AUTHORIZED BY THE CERTIFICATE OF INCORPORATION OR the bylaws. Upon the written request of the holders of not less than one-tenth of the voting power of all shares entitled to vote at the meeting, the president shall call a special shareholders' meeting for the purposes specified in such request and cause notice thereof to be given, EXCEPT THAT IF THE CORPORATION HAS A CLASS OF VOTING STOCK REGISTERED PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934, AS THE SAME HAS BEEN OR HEREAFTER MAY BE AMENDED FROM TIME TO TIME, AND NO PERSON HELD TEN PER CENT OR MORE OF THE VOTING POWER OF ALL SHARES OF THE CORPORATION ON FEBRUARY 1, 1988, THE PRESIDENT NEED NOT CALL SUCH MEETING EXCEPT UPON THE WRITTEN REQUEST OF THE HOLDERS OF NOT LESS THAN THIRTY-FIVE PER CENT OF SUCH VOTING POWER. If the president shall not, within fifteen days after the receipt of such shareholders' request, so call such meeting, such shareholders may call the same.

Sec. 6. (NEW) (a) There is established a commission on a Connecticut Partnership Compact comprised of the following members: The commissioners of economic development and labor, the cochairmen and ranking members of the joint standing committees on judiciary and labor and public employees, a representative from the Connecticut Business and Industry Association, a representative from the AFL-CIO, and six public members, two of whom shall represent the business

community of the state and one of whom shall represent the labor community of the state, appointed one each by the president pro tempore of the senate, the speaker of the house of representatives, the majority leader of the senate, the majority leader of the house of representatives, the minority leader of the senate and the minority leader of the house of representatives.

(b) The commission shall conduct public hearings and receive oral and documentary testimony concerning policies of corporations with respect to (1) their employees, (2) safety and environmental protection standards, (3) the communities in which they are located, and (4) such other areas as the commission deems appropriate.

(c) Not later than March 1, 1989, the commission shall adopt a Connecticut Partnership Compact containing standards of participation for corporations in the following areas:

(1) Policies affecting employees, including: (A) Provision of health benefits for employees, (B) promotion of education and job training, (C) affirmative action for minority and women employees and fair pay standards and (D) adherence to fair labor practices;

(2) Policies with respect to safety and environmental protection, including the establishment of safety procedures and protection for employees;

(3) Policies with respect to the community, including the establishment of hiring and job training programs to benefit local residents; and

(4) Policies with respect to such other areas as the commission deems appropriate.

Sec. 7. This act shall take effect from its passage.

Certified as correct by

_______________ *Legislative Commissioner.*

_______________ *Clerk of the Senate.*

_______________ *Clerk of the House.*

Approved June 7, 1988

_______________ *Governor, State of Connecticut.*

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M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: October 19, 1988

RE: ASSUMPTION OF STAKEHOLDER CONTRACTS WITH CONTROL TRANSFER

GENERAL PROPOSAL:

Require under state law that if the "buyer" of a corporation doing business in Massachusetts hires an employee from the "seller's" workforce, he must continue to compensate that employee at the "seller's" wage/benefit levels for a specified period, perhaps 6-12 months. A National Labor Relations Board determination that a collective bargaining agreement is in force would automatically terminate this "grandfather" period.

BACKGROUND:

A proposal to address under state law the assumption of "implicit" stakeholder contracts was discussed at some length at the August 31 Commission meeting, particularly as it applied to the "assumption" of collective bargaining agreements. The general sense of the discussion was that it would be desirable to require an acquiror of a corporation doing business in Massachusetts to "buy" all the seller's liabilities and obligations vis-a-vis its stakeholders to the greatest extent possible, including the assumption of any collective bargaining agreements. The major issues raised in that meeting concerned the meaningfulness of such a provision to different stakeholders and the pre-emption of such a proposal under the National Labor Relations Act in the collective bargaining agreement context. Research indicates the following: 1) Chapter 156B addresses the issue of the assumption of seller liabilities and obligations where there is a clear debtor-creditor relationship established under state law; 2) under federal law, the buyer of a corporation must assume the seller's collective bargaining contract only under very limited circumstances; 3) a state law explicitly requiring the assumption of collective bargaining agreements would almost certainly be unconstitutional in

light of current Supreme Court decisions and pre-emption doctrine in this area; and 4) a more general requirement under state law aimed at the temporary assumption of "implied" employment contracts might be an effective response to the concerns raised around collective bargaining agreements and provide all employees with greater protection in the control transfer situation.

The General Business Incorporation Law provides, in part, that the:

> "...rights of creditors of any constituent corporation shall not in any manner be impaired ... by any such consolidation or merger, but such resulting or surviving corporation shall be deemed to have assumed, and shall be liable for, all liabilities and obligations of each of the constituent corporations in the same manner and to the same extent as if such resulting or surviving corporation had itself incurred such liabilities or obligations...." M.G.L. c. 156B, § 80(5)(b).

This section is generally interpreted to mean that in the event of a consolidation or merger, the survivor corporation (buyer) assumes the liabilities and obligations of constituent corporations (sellers) with the nature of those liabilities and obligations defined the by state or federal law creating the debtor-creditor relationship. The easiest case is where an explicit contract for a specific period of time creates a debtor-creditor relationship between a domestic (Massachusetts incorporated) corporation. In that case, Chapter 156B provides clear language requiring the assumption of the obligations and liabilities under that contract by a "buyer" corporation. However, where the debtor-creditor relationship is based on an "implicit" contract, "buyer" liabilities and obligations appear to be limited to those that could be established under state law, based on specific statutory language or an implied or quasi-contract theory. It is important to note that § 80(5)(b) contains no language to prevent a "buyer" from re-negotiating his liabilities and obligations once assumed. However, the affected stakeholder enters such negotiations from the position he/she was in prior to the control transfer.

This type of provision offers clear protection to certain stakeholders in domestic Massachusetts corporations, most obviously individuals holding debt in the corporation, whether banks, bondholders or others. It also provides substantial protection to suppliers and sub-contractors with explicit contracts. A variety of other parties, such as landlords, utilities and insurers would also be protected. In each of these cases, § 80(5)(b) maintains the status quo during the control transfer by requiring the "buyer" to assume "seller" liabilities and obligations. While re-negotiation is always an option, a stakeholder whose contract as been assumed through this mechanism is in a far stronger bargaining position than one who begins with no explicit legal relationship with the "buyer" at all.

M.G.L. c. 156B, § 80(5)(b) also offers some protection to individuals/entities with outstanding accounts receivable for services performed for the "seller" up to the control transfer but who have no formal contract. This group is assured payment for services rendered if creditor status can be shown under contract law which should be relatively easy. However, there is no assurance that they will continue to perform services for the "buyer" corporation in the future and to the extent they are in a position to negotiate there are no guarantees that the "buyer" will offer comparable terms. This is the classic "implied" contract situation referred to in the academic literature as a major cost-saving mechanism in takeovers, since it is far easier for new management (the "buyer") to sever "implied" contracts than incumbent management. Individuals and firms providing services to the "seller" corporation appear to be the primary groups within this category, and, the largest and potentially most severely affected sub-group would appear to be the employees of the "seller" corporation itself.

M.G.L. c. 156B, § 80(5)(b) offers little protection to the vast majority of employees, whether covered by a collective bargaining agreement or not, for two reasons. First, when a "buyer" acquires corporate assets, he does not buy the workforce. Absent an explicit contract of employment for a term of years, "buyer" has no prospective obligation the "seller's" employees. "Buyer's" only legal requirement is to pay for services rendered to the "seller" consistent with the terms and conditions of employment prior to acquisition. The "buyer" has complete freedom to rehire (or not) members of "seller's" workforce and set new terms and conditions since for legal purposes the "buyer" is creating a new employment relationship. Second, M.G.L. c. 156B, § 80(5)(b) applies only to domestic Massachusetts firms, although similar provisions exist in other states' general incorporation laws. As a result, there may be differential treatment of employees and other stakeholders with "implicit" contracts depending on "seller's" state of incorporation.

The National Labor Relations Act (NLRA) further complicates this discussion. If a "buyer" chooses to rehire individuals from the "seller's" workforce and those workers were covered by a collective bargaining agreement with "seller," the National Labor Relations Board (NLRB) may, under certain circumstances, find that the "buyer" must recognize and bargain with the union or, in rare instances, must assume the agreement. [Please see attached memo]. However, a determination that "buyer" has a duty to recognize and bargain does not mean that there is a duty to start bargaining from the terms of the old collective bargaining agreement. Under current federal law, the "buyer" is free to set new terms and conditions as he establishes new employment relations (hires). Therefore, except in the rare instances where the NLRB determines a collective bargaining agreement must be assumed or where the "buyer" voluntarily assumes the terms and conditions of a collective bargaining agreement, the effect is the same under state law whether or not the workforce is covered by a

collective bargaining agreement. Since there is no explicit contract to bind the "buyer" prospectively, employees negotiate from square one as opposed to starting from the status quo ante.

There are several concerns raised about "implied" contracts in the takeover context: 1) the potential short-term, negative impact on stakeholders, particularly employees, associated with dislocations and/or pay cuts following a control transfer; 2) the long-term effects on productivity and competitiveness caused by employee and supplier insecurity which deters optimal investment in skills upgrading and reinvestment by suppliers in product and process development; 3) the incentives generated for defining such relationships through explicit contracts which do not accurately reflect a constantly changing conditions and introduce a rigidities and inefficiencies into these relationships. In theory, there is no distinction between the effects of re-negotiation of an "implied" contract for employment or for the supply of services/products where the concern is that the "buyer's" new terms and conditions will be less favorable than the "seller's" were. In both cases, there will be an income loss to the stakeholder. However, as a practical matter, suppliers often have a number of current or potential clients and, therefore, more of a cushion. By contrast, employees usually have only one "client," the employer, and may, because of their skill levels or specialization and/or the characteristics of the local labor market, have few immediate options for comparable employment. Under such circumstances, sudden losses in wages and/or benefits may pose a very similar threat to that of dislocation. This proposal is designed to provide a buffer for employees with "implied" contracts that create expectations of continuing wages and benefits during the transition period following a transfer of control. It is designed to maintain the status quo during that period to enable new management and employees to assess what is often a rapidly evolving situation and obtain the information needed to make informed decisions about future employment options. It also provides a standstill period during which the NLRB can determine what status a pre-existing collective bargaining agreement may have without penalty to workers hired from the "seller's" workforce. During this period, employees would have an opportunity to demonstrate their value to "buyer" who in turn has an opportunity to evaluate employee productivity and "know-how" as a realistic basis future negotiations. Employees would receive the same protections afforded other creditors with explicit contracts extending through the specified term and begin the re-negotiation or concessionary bargaining process from a status quo ante position rather than square one. It is not designed to prevent takeovers. However, it should have the effect of deterring highly-leveraged takeovers largely "financed" through transfer payments from employees in the form of wage and/or benefit cuts. In conjunction with a business combination law designed to deter highly-leveraged and under-financed takeovers funded through asset sales, this proposal should contribute to deterring "unproductive" takeovers while continuing to permit efficiency producing takeovers.

RECOMMENDATION A:

File legislation to create a state fair labor standard to require that if the "buyer" of a corporation doing business in Massachusetts hires an employee from the "seller's" workforce, he must compensate that employee at the same wage/benefit levels for a specified period, perhaps 6-12 months. An NLRB determination that a collective bargaining agreement was in force would automatically terminate this "grandfather" period.

PROS:

Employees with "implicit" employment contracts would, if rehired, receive the same protections that creditors with explicit contracts do under M.G.L. c. 156B(5)(b).

Closer approximation to equitable treatment for all stakeholders with creditor relations to "buyer" whether through explicit or implicit contracts.

Incentive to "buyer" to factor in social costs associated with employee disruption/dislocation before beginning the transaction

Where "seller" workforce covered by a collective bargaining agreement and has high wages/benefits, creates incentive for "buyer" to assume the agreement to bargain for concessions while preserving bargaining position of "seller's" former employees.

Deters those highly-leveraged and/or under-financed takeovers which rely significantly on employee wage and benefit cuts to pay down debt accumulated to finance takeover but permits takeovers financed through efficiency or productivity gains to go forward

In conjunction with a business combination law, which would deter "financial" takeovers financed through asset sales, further deters "financial" takeovers by excluding up-front cuts in labor costs as a source of financing.

CONS:

Creates incentives for "buyer" to not rehire "seller's" workforce where other labor is available, i.e. in high unemployment areas, potentially exacerbating the situation. The effectiveness of such a proposal as a deterrent to "financial" takeovers would appear to vary, therefore, with the overall performance of the economy; less effective when concerns about disruptions and dislocations would be greatest.

In the event of a reduction in the workforce, creates incentives for "buyer" to lay-off the oldest (usually the highest paid and hardest to re-employ) workers first.

Does not directly address the concerns of organized labor regarding the avoidance of collective bargaining agreements through reorganization, consolidation or merger.

Potential NLRA/NLRB conflicts re assumption/successorship which should be minimized through explicit termination of "grandfather" period if collective bargaining agreement comes into force.

May raise NLRA conflicts re "company unions" when re-negotiation begins in a non-union shop

Possible ERISA conflicts based on mandated benefits.

<u>RECOMMENDATION B</u>:

Recommend amendment of NLRA to reverse current Supreme Court doctrine upholding NLRB decisions re "successorship" which may require a "buyer" to recognize and bargain with a previously certified union under certain circumstances but rarely require the actual assumption of collective bargaining agreements in the event of a control transfer.

PROS:

Directly addresses the concerns of organized labor regarding the avoidance of collective bargaining agreements through reorganization, consolidation or merger.

CONS:

Uncertain outcome

Takes a long time

Doesn't address the concerns of the vast majority of Massachusetts workers not covered by collective bargaining agreements.

The Commonwealth of Massachusetts
Executive Office of Labor
One Ashburton Place Room 2112
Boston, MA 02108

MICHAEL S DUKAKIS
GOVERNOR
PAUL J EUSTACE
SECRETARY

MEMORANDUM

TO: Commission members

FROM: Paul J. Eustace
Joseph Alviani

DATE: August 31, 1988

RE: RECOMMENDATIONS REGARDING ASSUMPTION OF COLLECTIVELY BARGAINED CONTRACTS BY ACQUIRING CORPORATIONS

THE PROBLEM:

Currently, purchasers or acquirers of a business need not honor collective bargaining contracts in effect at the time of purchase. They need not recognize and bargain with any existing unions unless they are determined to be successor employers by the National Labor Relations Board. Nor are they required to hire any or all of the employees of the business under the previous owner.*

While determination that a buyer is a successor employer provides little protection for employees because of the lack of collective bargaining agreement continuity, the successor employer determination is itself an uncertain and potentially lengthy process.

The NLRB will decide that an employer is a successor employer if substantial continuity of business operations is maintained based on the totality of circumstances in each case. Factors that determine continuity of business operations include whether the buyer's workforce is primarily composed of previous employees; product line continuity; asset, equipment, and plant acquisition; continuity of supervisors; appropriateness of the former bargaining unit.

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* While a union may bargain for a contract provision which requires the assumption of the collective bargaining agreement as a condition of purchase and sale agreements, this provision is rarely achieved in collective bargaining. Further, it binds only the seller employer, so can be enforced only through an injunction staying a purchase and sale agreement prior to its consummation.

Because a major factor in the successor employer's determination is based on the number of former employees that are rehired, the purchaser can avoid a successor employer determination merely by hiring a majority of new workers. Further, the purchaser is free to set the terms and conditions of work unilaterally prior to a successor determination, which can affect the outcome of the determination. Many purchasers have avoided successor employer status by not rehiring former employees causing needless dislocation and economic loss to both seasoned workers and the local economies.

Additionally, because these principal factors affecting employer successorship status are within the control of the purchaser, employees are put in a precarious bargaining position. If the purchasing employer is intent on lowering wages and working conditions, the threat that it will not rehire the previous workforce is usually enough to force concession bargaining. While weaker contracts provide a way for a takeover employer to have employees disproportionately bear the cost of the buyout through labor cost reductions and might even create higher short term company profits, they also lead to deterioration in the standard of living of Massachusetts workers and deteroriation of the local economy.

From the public policy point of view, the lack of liability for existing collective bargaining contracts reflects an unacceptable double standard. As the Secretary-Treasurer of the AFL-CIO, Thomas Donahue, stated in testimony before Congress:

> To allow such pre-existing contracts to be ignored if a reorganization occurs, incites restructuring for the sole purpose of reaping whatever gains can be achieved from breaching contractual commitments. A society that believes in the sanctity of contracts should not tolerate such incentives.

Contracts with employees should be accorded the same standard of legal obligation as all other contracts, else the incentive to bargain collectively is downgraded.

EXAMPLES:
There have been a number of examples of these problems occuring in recent buyouts of Massachusetts-based firms:

James River Paper in Hyde Park was purchased this spring by Nolichucky Corporation. There was a good deal of confusion over the company's obligation to bargain which in turn caused a good deal of disruption. The Secretary of Labor and the Governor's Office of Economic Development as well as Mayor Flynn's office got involved mediating between the Paperworkers Union and the new owners. This was resolved to the satisfaction of all concerned because of public involvement.

Greenfield Tap & Die was purchased by Harbor Industries almost two years ago. The United Electrical Workers had just negotiated a new contract with TRW, the previous owner, before the sale. Harbor voided the contract which triggered 8-9 months of tense labor strife. After a threatened layoff of all employees, the union settled on a concessionary contract which included wage and benefit cuts of over $3.40/hour.

Simond Cutting in Fitchburg, employing 285+ people who are members of the United Steelworkers Union was purchased from Household Manufacturing by Greylock Management Group. The contract was voided under the new management. Everyone was laid off. At the urging of the union, all reapplied for their jobs and most were rehired. Under a new contract settlement, wage and benefit cuts were over $2/hour.

RECOMMENDATIONS:

OPTION ONE:

The Commission should recommend that the purchasers of businesses in the Commonwealth be required to assume existing collective bargaining agreements as a condition of purchase, merger, or other form of acquisition. This change could be made through the Mature Industries Act

PROS:

Requiring the assumption of existing collective bargaining agreements as a condition of acquisition will help alleviate some worker dislocation due to layoffs motivated by an employer's desire to not bargain with a union.

This would eliminate the current legal double standard between contracts with labor organizations versus other contracts. A new employer would only be able to change contract conditions as a part of negotiations that take place when the contract expires, the same condition which applies to other contracts.

This would equalize the balance of power between the acquiring employer and employees in a buyout or merger, by continuing the relationship that existed between the old employer and employees through the duration of the contract.

This clarifies liabilities and obligations for new employers by eliminating the uncertainties of successor obligations which will be imposed by the NLRB if it decides that the acquiring employer is a successor employer, regardless of the lack of assumption of the collective bargaining contract by the purchaser. Because the NLRB successor employer test is decided in each case based on the totality of factual circumstances, this determination can involve lengthy, costly administrative proceedings.

This imposes a stricter obligation on new owners of Massachusetts-based firms which may serve as a kind of poison pill in deterring takeovers.

CONS:

Because it imposes a stricter obligation, it may increase the cost of a buyout or merger.

It will limit the purchaser's latitude in restructuring the acquired company until the collective bargaining agreement expires (almost always not more than three year's duration).

OPTION TWO:

The Commission should recommend that the National Labor Relations Act be amended to require that a purchasing or acquiring employer assume collectively bargained contracts existing at the time of purchase, merger or other restructuring.

PROS:

It would be an easier recommendation to make, no doubt, as a mandate to assume collective bargaining contracts would be controversial.

Although state action would probably be upheld in this area, such an amendment would provide equal standards of a purchasing employers' labor liability throughout the states.

CONS:

Although the Senate Labor and Human Resources Committee has comprehensive labor law reform on its agenda for the coming years, they are a long way from enacting such reforms. Such a recommendation provides a way to avoid taking state action.

The Commonwealth of Massachusetts
Executive Office of Labor
One Ashburton Place Room 2112
Boston, MA 02108

MICHAEL S. DUKAKIS
GOVERNOR

PAUL J. EUSTACE
SECRETARY

M E M O R A N D U M

TO: Commission members

FROM: Paul J. Eustace
Joseph Alviani

DATE: October 12, 1988

RE: RECOMMENDATIONS REGARDING EMPLOYEE PROTECTIONS AND ASSUMPTION OF COLLECTIVELY BARGAINED CONTRACTS BY ACQUIRING CORPORATIONS

THE PROBLEM:

Currently, Massachusetts corporation law requires acquiring corporations to assume the debts and business obligations of the acquired business. However, these kinds of state required business obligations have been interpreted by federal courts not to include the assumption of collectively bargained contracts. Further, under the National Labor Relations Act, new owners need not recognize and bargain with any existing unions unless they are determined to be successor employers by the National Labor Relations Board. Nor are they required to hire any or all of the employees of the business under the previous owner.*

The NLRB will decide that an employer is a successor employer if substantial continuity of business operations is maintained based on the totality of circumstances in each case. Some factors that determine continuity of business operations include whether the buyer's workforce is primarily composed of previous employees; product line continuity; asset, equipment, and plant acquisition; continuity of supervisors; and appropriateness of the former bargaining unit.

In addition, the successor employer determination is itself an uncertain and potentially lengthy process, and determination that a buyer is a successor employer provides little protection for employees because of the lack of collective bargaining agreement continuity. Because a major

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* Although a union may bargain for a contract provision which requires the assumption of the collective bargaining agreement as a condition of a purchase and sale agreement, this provision is rarely achieved in collective bargaining. Further, it binds only the seller employer, so usually can be enforced only through an injunction staying a purchase and sale agreement prior to its consummation.

factor in the successor employer's determination is the number of former employees that are rehired, the purchaser can avoid a successor employer determination merely by hiring a majority of new workers. Further, the new owner is free to set the terms and conditions of work unilaterally prior to a successor determination, which can affect the outcome of the determination. Many purchasers have avoided successor employer status by not rehiring former employees, causing needless dislocation and economic loss to both seasoned workers and the local economies.

Additionally, with these principal factors affecting employer successorship status within the control of the purchaser, employees are put in a precarious bargaining position. If the purchasing employer is intent on lowering wages and working conditions, the threat that it will not rehire the previous workforce is usually enough to force concession bargaining. While weaker contracts provide a way for a takeover employer to have employees disproportionately bear the cost of the buyout through labor cost reductions and might even create higher short term company profits, they lead to deterioration in the standard of living of Massachusetts workers and deteroriation of the local economy.

From the public policy point of view, the lack of liability for existing collective bargaining contracts reflects an unacceptable double standard. As the Secretary-Treasurer of the AFL-CIO, Thomas Donahue, stated in testimony before Congress:

> To allow such pre-existing contracts to be ignored if a reorganization occurs, incites restructuring for the sole purpose of reaping whatever gains can be achieved from breaching contractual commitments. A society that believes in the sanctity of contracts should not tolerate such incentives.

Contracts with employees should be accorded the same standard of legal obligation as all other contracts. Otherwise the incentive to bargain collectively is undermined.

EXAMPLES:
There have been a number of examples of these problems occuring in recent buyouts of Massachusetts-based firms:

James River Paper in Hyde Park was purchased this spring by Nolichucky Corporation. There was a good deal of confusion over the company's obligation to bargain which in turn caused a good deal of disruption. The Secretary of Labor and the Governor's Office of Economic Development as well as Mayor Flynn's office got involved mediating between the Paperworkers Union and the new owners. This was resolved to the satisfaction of all concerned only because of this public involvement.

Greenfield Tap & Die was purchased by Harbor Industries almost two years ago. The United Electrical Workers had just negotiated a new contract with TRW, the previous owner, before the sale. Harbor voided the contract which triggered 8-9 months of tense labor strife. After a threatened layoff of all employees, the union settled on a concessionary contract which included wage and benefit cuts of over $3.40/hour.

Simond Cutting in Fitchburg, employing 285+ people who are members of the United Steelworkers Union was purchased from Household Manufacturing by Greylock Management Group. The contract was voided under the new management. Everyone was laid off. At the urging of the union, all reapplied for their jobs and most were rehired. Under a new contract settlement, wage and benefit cuts were over $2/hour.

RECOMMENDATIONS:

OPTION ONE:

The Commission should recommend that the acquirers of businesses operating in the Commonwealth be required to assume existing collective bargaining agreements as a condition of purchase, merger, or other form of acquisition. This change could be made through an amendment to the corporations law.

PROS:

This would eliminate the current legal double standard between contracts with labor organizations compared to other contracts. A new employer would only be able to change contract conditions as a part of negotiations that take place when the contract expires or is reopened, the same condition which applies to other contracts.

This would equalize the balance of power between the acquiring employer and employees in a buyout or merger, by continuing the relationship that existed between the old employer and employees through the duration of the contract.

This clarifies liabilities and obligations for new employers by eliminating the uncertainties of successor obligations which may be imposed by the NLRB. Because the NLRB successor employer test is decided in each case by the totality of factual circumstances, this determination can involve lengthy, costly, legal proceedings.

Requiring the assumption of existing collective bargaining agreements as a condition of acquisition will help alleviate some worker dislocation due to layoffs motivated by an employer's desire to not bargain with a union.

This imposes a stricter obligation on new owners of Massachusetts based firms which may serve as a kind of poison pill in deterring takeovers.

CONS:

Given the intent of Congress to place collective bargaining relationships solely within the jurisdiction of the National Labor Relations Board, it seems likely that this provision would not survive a legal challenge based on NLRA preemption.

Because it imposes a stricter obligation, it may increase the cost of a buyout or merger.

It will limit the purchaser's latitude in restructuring the acquired company until the collective bargaining agreement expires (almost always not more than three year's duration).

It does not protect employees from being laid off.

OPTION TWO:

The Commission should recommend that state labor law be amended to require that acquirers of businesses operating in Massachusetts maintain for a limited period of time (one year) the wages and certain benefits of employees at no less than the level they received under the prior owner.

PROS:

This provision would be more likely to withstand a preemption test because it sets a labor standard which applies to all employees. It could be drafted to avoid conflict with collective bargaining contracts when they are in effect.

It provides a measure of stability for all employees and communities which might be affected by dislocation from takeovers, not just those situations where there are collectively bargained contracts. It provides a cushion of time which would ease the transition for workers and the community.

It imposes a stricter obligation on new owners of Massachusetts based firms which may serve as a kind of poison pill in deterring takeovers.

It clarifies the liabilities and obligations for new employers.

It removes one of the short term incentives for a buyer to nullify a collectively bargaining contracts or to lay off in order to avoid determination as a successor employer.

CONS:

It does not provide employees all the protections afforded by assumption of a collectively bargained contract, such as grievance procedures and work rules.

It might create an incentive for new owners to lay off older employees in order to hire cheaper labor.

Because it imposes a stricter obligation, it may increase the cost of a buyout or merger.

For a period of time it will limit the purchaser's latitude in restructuring the acquired company.

OPTION THREE:

The Commission should recommend that the National Labor Relations Act be amended to require that a purchasing or acquiring employer assume collectively bargained contracts existing at the time of purchase, merger or other restructuring.

PROS:

It would be an easier recommendation to make, no doubt, as a state mandate to assume collective bargaining contracts or establish a temporary wage floor would be controversial.

It would provide equal standards for a purchasing employer's labor liability throughout the states.

CONS:

Although the Senate Labor and Human Resources Committee has comprehensive labor law reform on its agenda for the coming years, they are a long way from enacting such reforms. Such a recommendation de facto would provide no employee protection for the forseeable future.

The Commonwealth of Massachusetts
Executive Office of Labor
One Ashburton Place Room 2112
Boston, MA 02108

MICHAEL S. DUKAKIS
GOVERNOR

PAUL J. EUSTACE
SECRETARY

MEMORANDUM

TO: Commission members

FROM: Paul J. Eustace
Joseph Alviani

DATE: November 8, 1988

RE: RECOMMENDATIONS REGARDING EMPLOYEE PROTECTIONS AND ASSUMPTION OF COLLECTIVELY BARGAINED CONTRACTS BY ACQUIRING CORPORATIONS

THE PROBLEM:

Currently, Massachusetts corporation law requires acquiring corporations to assume the debts and business obligations of the acquired business. However, these kinds of state required business obligations have been interpreted by federal courts not to include the assumption of collectively bargained contracts. Further, under the National Labor Relations Act, new owners need not recognize and bargain with any existing unions unless they are determined to be successor employers by the National Labor Relations Board. Nor are they required to hire any or all of the employees of the business under the previous owner.*

The NLRB will decide that an employer is a successor employer if substantial continuity of business operations is maintained based on the totality of circumstances in each case. Some factors that determine continuity of business operations include whether the buyer's workforce is primarily composed of previous employees; product line continuity; asset, equipment, and plant acquisition; continuity of supervisors; and appropriateness of the former bargaining unit.

In addition, the successor employer determination is itself an uncertain and potentially lengthy process, and determination that a buyer is a successor employer provides little protection for employees because of the lack of collective bargaining agreement continuity. Because a major

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factor in the successor employer's determination is the number of former employees that are rehired, the purchaser can avoid a successor employer determination merely by hiring a majority of new workers. Further, the new owner is free to set the terms and conditions of work unilaterally prior to a successor determination, which can affect the outcome of the determination. Many purchasers have avoided successor employer status by not rehiring former employees, causing needless dislocation and economic loss to both seasoned workers and the local economies.

Additionally, with these principal factors affecting employer successorship status within the control of the purchaser, employees are put in a precarious bargaining position. If the purchasing employer is intent on lowering wages and working conditions, the threat that it will not rehire the previous workforce is usually enough to force concession bargaining. While weaker contracts provide a way for a takeover employer to have employees disproportionately bear the cost of the buyout through labor cost reductions and might even create higher short term company profits, they lead to deterioration in the standard of living of Massachusetts workers and deteroriation of the local economy.

From the public policy point of view, the lack of liability for existing collective bargaining contracts reflects an unacceptable double standard. As the Secretary-Treasurer of the AFL-CIO, Thomas Donahue, stated in testimony before Congress:

> To allow such pre-existing contracts to be ignored if a reorganization occurs, incites restructuring for the sole purpose of reaping whatever gains can be achieved from breaching contractual commitments. A society that believes in the sanctity of contracts should not tolerate such incentives.

Contracts with employees should be accorded the same standard of legal obligation as all other contracts. Otherwise the incentive to bargain collectively is undermined.

EXAMPLES:
There have been a number of examples of these problems occuring in recent buyouts of Massachusetts-based firms:

James River Paper in Hyde Park was purchased this spring by Nolichucky Corporation. There was a good deal of confusion over the company's obligation to bargain which in turn caused a good deal of disruption. The Secretary of Labor and the Governor's Office of Economic Development as well as Mayor Flynn's office got involved mediating between the Paperworkers Union and the new owners. This was resolved to the satisfaction of all concerned only because of this public involvement.

Greenfield Tap & Die was purchased by Harbor Industries almost two years ago. The United Electrical Workers had just negotiated a new contract with TRW, the previous owner, before the sale. Harbor voided the contract which triggered 8-9 months of tense labor strife. After a threatened layoff of all employees, the union settled on a concessionary contract which included wage and benefit cuts of over $3.40/hour.

Simond Cutting in Fitchburg, employing 285+ people who are members of the United Steelworkers Union was purchased from Household Manufacturing by Greylock Management Group. The contract was voided under the new management. Everyone was laid off. At the urging of the union, all reapplied for their jobs and most were rehired. Under a new contract settlement, wage and benefit cuts were over $2/hour.

[add MOTION adopted by Commission]

RECOMMENDATIONS:

OPTION ONE:

The Commission should recommend that the acquisitors of businesses operating in the Commonwealth be required to assume existing collective bargaining agreements as a condition of purchase, merger, or other form of acquisition. This change could be made through an amendment to the corporations law.

PROS:

This would eliminate the current legal double standard between contracts with labor organizations compared to other contracts. A new employer would only be able to change contract conditions as a part of negotiations that take place when the contract expires or is reopened, the same condition which applies to other contracts.

This would equalize the balance of power between the acquiring employer and employees in a buyout or merger, by continuing the relationship that existed between the old employer and employees through the duration of the contract.

This clarifies liabilities and obligations for new employers by eliminating the uncertainties of successor obligations which may be imposed by the NLRB. Because the NLRB successor employer test is decided in each case by the totality of factual circumstances, this determination can involve lengthy, costly, legal proceedings.

Requiring the assumption of existing collective bargaining agreements as a condition of acquisition will help alleviate some worker dislocation due to layoffs motivated by an employer's desire to not bargain with a union.

This imposes a stricter obligation on new owners of Massachusetts based firms which may serve as a kind of poison pill in deterring takeovers.

CONS:

Given the intent of Congress to place collective bargaining relationships solely within the jurisdiction of the National Labor Relations Board, it seems likely that this provision would not survive a legal challenge based on NLRA preemption.

Because it imposes a stricter obligation, it may increase the cost of a buyout or merger.

It will limit the purchaser's latitude in restructuring the acquired company until the collective bargaining agreement expires (almost always not more than three year's duration).

It does not protect employees from being laid off.

OPTION TWO:

The Commission should recommend that state labor law be amended to require that acquisitors of businesses operating in Massachusetts maintain for a limited period of time (one year) the wages and certain benefits of employees at no less than the level they received under the prior owner.

This is an attempt to provide a cushion period for employees after a buyout. Where a collective bargaining agreement is in effect, it will not inhibit negotiations but only establish a minimum labor standard for wages andbenefits for the one year after purchase.

Examples of wage cuts in Massachusetts companies after buyouts and the cost estimates of this proposal which would have been prohibited during the first year of purchase are included below:

> Greenfield Tap and Dye: 320 non-management employees received $3.40/hour cut after buyout; total savings to employer/cost to employees = $2,263,040/year. (There have been additional, less measurable costs to employer due to roughly 50% turnover rate since these provisions were put in place.)
>
> Simond Cutting: 285 employees with $2.00/hour wage cut; savings to company/cost to employees = $1,185,600/year.

PROS:

This provision would be more likely to withstand a preemption test because it sets a labor standard which applies to all employees. It could be drafted to avoid conflict with collective bargaining contracts when they are in effect.

It provides a measure of stability for all employees and communities which might be affected by dislocation from takeovers, not just those situations where there are collectively bargained contracts. It provides a cushion of time which would ease the transition for workers and the community.

It imposes a stricter obligation on new owners of Massachusetts based firms which may serve as a kind of poison pill in deterring takeovers.

It clarifies the liabilities and obligations for new employers.

It removes one of the short term incentives for a buyer to nullify a collectively bargaining contracts or to lay off in order to avoid determination as a successor employer.

CONS:

It does not provide employees all the protections afforded by assumption of a collectively bargained contract, such as grievance procedures and work rules.

It might create an incentive for new owners to lay off older employees in order to hire cheaper labor.

Because it imposes a stricter obligation, it may increase the cost of a buyout or merger.

For a period of time it will limit the purchaser's latitude in restructuring the acquired company.

OPTION THREE:

An employee that faces a wage and benefit cut of over 10% would have the option of accepting this cut or taking a layoff with benefits. Basically, this would add to the definition of an involuntary layoff someone whose working conditions were so deteriorating as to effectively equal a constructive layoff.

PROS:

This would give the individual employee the option to choose between a wage reduction or layoff.

This provision would not limit employers' ability to negotiate or install reduced wages and benefits.

CONS:

This would not protect the standard of living of Massachusetts workers nor strengthen the principle of honoring a contract.

OPTION FOUR:

The Commission should recommend that the National Labor Relations Act be amended to require that a purchasing or acquiring employer assume collectively bargained contracts existing at the time of purchase, merger or other restructuring.

PROS:

It would be an easier recommendation to make, no doubt, as a state mandate to assume collective bargaining contracts or establish a temporary wage floor would be controversial.

It would provide equal standards for a purchasing employer's labor liability throughout the states.

CONS:

Although the Senate Labor and Human Resources Committee has comprehensive labor law reform on its agenda for the coming years, they are a long way from enacting such reforms. Such a recommendation de facto would provide no employee protection for the forseeable future.

DELAWARE
Regular Session

Chapter 220, Laws 1988

House Bill No. 455

AN ACT TO AMEND CHAPTER 7, TITLE 19, DELAWARE CODE, BY ADDING A NEW SECTION, PROTECTING CERTAIN LABOR CONTRACTS AGAINST TERMINATION OR IMPAIRMENT BECAUSE OF MERGER, CONSOLIDATION, SALE OF ASSETS OR BUSINESS COMBINATION.

WHEREAS, it is in the interest of this State to protect persons engaged in employment in this State under certain labor contracts; and

WHEREAS, it would be against the public welfare for a corporate merger, consolidation, sale of assets or other business combination to cause or result in the termination of such labor contracts until those contracts reach their natural termination dates.

NOW, THEREFORE:

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE:

Section 1. Amend Chapter 7, Title 19, Delaware Code by adding a new section to read as follows:

"§706(a) Notwithstanding any other provisions of this Code, no merger, consolidation, sale of assets or business combination, shall result in the termination or impairment of the provisions of any labor contract covering persons engaged in employment in this State and negotiated by a labor organization or by a collective bargaining agent or other representative. Notwithstanding such merger, consolidation, sale of assets or business combination, such labor contract shall continue in effect until its termination date or until otherwise agreed by the parties to such contract or their legal successors.

(b) For purposes of this section:

(1) 'Business combination' includes any merger, consolidation, joint venture, lease, sale, dividend exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions) whether with a subsidiary or otherwise; and

(2) 'Employment' shall have the meaning set forth in §3302(9)(H) and (I) of this Title.

(c) In the event that any such employee is denied or fails to receive wages, benefits, or wage supplements as a result of a violation of this section, and in addition to injunctive or other relief provided by laws, the provisions of Chapter 11 of this Title shall be applicable to secure recovery against the merged or consolidated corporation or the resulting corporation, notwithstanding anything contained therein or elsewhere to the contrary. The remedies provided for herein shall be available against any of the parties to such merger, consolidation, sale of assets or business combination.

(d) This section is enacted in order to protect the employment interests of all persons engaged in employment in Delaware under existing labor contracts and shall be liberally construed in every case in order to achieve that purpose. If any provision of this Act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to that end the provisions of this Act are declared to be severable."

Approved, April 8, 1988

Effective, April 8, 1988

ILLINOIS
Regular Session

Public Act 85-300, Laws 1987

House Bill No. 332

AN ACT relating to collective bargaining agreements.

<u>Be it enacted by the People of the State of Illinois, represented in the General Assembly:</u>

Section 1. (a) Where a collective bargaining agreement between an employer and a labor organization contains a successor clause, such clause shall be binding upon and enforceable against any successor employer who succeeds to the contracting employer's business, until the expiration date of the agreement therein stated. No such successor clause shall be binding upon or enforceable against any successor employer for more than 3 years from the effective date of the collective bargaining agreement between the contracting employer and the labor organization.

(b) As used in this Section, "successor employer" means any purchaser, assignee, or transferee of a business the employees of which are subject to a collective bargaining agreement, if such purchaser, assignee, or transferee conducts or will conduct substantially the same business operation, or offer the same service, and use the same physical facilities, as the contracting employer.

(c) This Section shall not apply to a receiver or trustee in bankruptcy of any contracting employer who has gone into receivership or bankruptcy, or to any employer who acquires a business from a receiver or trustee in bankruptcy.

(d) An employer who is a party to a collective bargaining agreement containing a successor clause has the affirmative duty to disclose the existence of such agreement and such clause to any successor employer. Such disclosure requirement shall be satisfied by including in any contract of sale, agreement to purchase, or any similar instrument of conveyance, a statement that the successor employer is bound by such successor clause as provided for in the collective bargaining agreement. Failure of an employer to disclose the

existence of a collective bargaining agreement containing a successor clause as required by this subsection (d) shall not affect the enforceability of such collective bargaining agreement against a successor employer.

Section 2. Whoever violates this Act is guilty of a business offense with a fine not to exceed $5,000.

Approved, September 10, 1987

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS FOR A DISLOCATION CHARGEBACK MECHANISM

GENERAL PROPOSAL:

Establish one or more mechanisms to charge back to the buyer costs caused by takeover-related dislocation of stakeholders, including, but not necessarily limited to, the program and administrative costs of the various employment & training and economic development programs that respond to such dislocations and assist in dislocated worker/community transition. Direct costs could include re-employment assistance benefits, extended health care coverage, job counseling, referral and training services as well as support services such as child care provided by employment and training programs.

BACKGROUND:

The Commission is acutely aware of the broad variety of concerns raised by takeover-related activities, including, but not limited to, disruptions to employees, communities, consumers, suppliers and creditors; and deterrents to long-term investment in R&D, product, market and human resource development and physical plant. However, there also appears to be a general consensus among Commission members that the state should not, even if it could, seek to prevent all takeovers since they are an integral part of the process of "creative destruction" which fosters productivity and competitiveness and ensures long-term economic growth and job creation. In this sense, takeover-related disruptions are simply a special subset of the disruptions employees, communities, consumers, suppliers and creditors face due to technological and societal change and their effects on product and industry life cycles. In economic terms, the problem is not that these disruptions occur, since in the long-term they often lead to the creation of new social wealth. Rather, the

problem is that the long-term benefits usually do not accrue to those who bear the short-term costs. Historically, this type of mismatch in social costs and benefits has been mitigated through government programs, the most obvious being the unemployment security system, funded jointly by employers and government, to provide temporary income maintenance to dislocated workers. The "chargeback" proposal is an expansion of this model to include other services and benefits offered to dislocated workers in Massachusetts.

The Commonwealth, through the Executive Offices of Economic Affairs and of Labor, offers a broad variety of services and benefits to Massachusetts workers dislocated through plant closings or layoffs to expedite their re-employment and facilitate economic transition. The Commonwealth also has programs and agencies equipped to address the needs of community and supplier dislocation through economic development grants, community development loans and firm-specific loans and/or loan guarantee for new product development etc. The programs most often cited in this context were created by the Mature Industries Act as a response to growing concerns about worker/ community dislocation caused by structural economic change as Massachusetts continued to move from mill-based to more technology intensive manufacturing methods. These programs include the plant closing and re-employment assistance benefit provisions implemented by the Department of Employment and Training (DET) and the Worker Assistance Centers run by the Industrial Services Program (ISP). There were several other programs created by the Mature Industries Act including the business assistance component of the ISP, the Economic Stabilization Trust (EST) and the Massachusetts Product Development Corporation (MPDC). Other state programs unrelated to the Mature Industries Act have also played significant roles in this context, including the Bay State Skills Corporation (BSSC), the Center for Applied Technology (CAT), the Massachusetts Business Development Corporation (MBDC) and the Thrift Fund. Although none of these programs was established specifically as a response to takeover-related dislocation, each can serve to cushion immediate stakeholder disruptions often associated with takeovers.

Currently, these programs are funded almost entirely through a combination of state and federal (Job Training Partnership Act, Title III) monies. In this way they differ radically from the unemployment security model which is based on two assumptions: 1) since labor dislocation/mobility in general produces long-term social benefits at the expense of the specific individuals dislocated, society should underwrite, to some degree, those personal costs to ensure the broader benefits; and 2) since employers play a key role in the dislocation of workers and enjoy many of the benefits of labor mobility, they should pay a substantial share of the social costs associated with labor dislocation/mobility with the taxpayers picking up the remainder. Over the years, Massachusetts has determined that the UI system alone is not adequate to meet our need for the highly-skilled and flexible workforce essential to sustained growth. The Mature Industries

Commission, composed of business, labor, academic and public members, concluded that the additional services and benefits offered by the programs described above were necessary to deal effectively with worker/community dislocation. However, the innovative nature of these programs at that time required that they be funded with taxpayer dollars. This chargeback proposal is, in essence, a proposal to require employers that place increased demand on these programs to assume their share of the costs. In this respect it resembles any experience rated insurance system whether unemployment or automobile collision insurance. In a number of programs this has already become the practice. The ISP usually receives approximately $5 from the private sector for each taxpayer dollar it spends. Similarly, BSSC training programs are funded on a 50-50 match basis. This proposal would formalize what large portions of the Massachusetts business community has come to view as responsible behavior and ensure that all employers meet this standard of conduct.

The major variables in considering recommendations based on this proposal appear to be: 1) definition of a triggering event with its potential for inequitable treatment of a) workers dislocated for different reasons and b) management teams that acquire control through different means; 2) whether payment is up-front or after the fact or some combination of the two depending on the definition of the triggering event; 3) what services/benefits should be included; and 4) how should the value be established.

The simplest form of this proposal is a straight chargeback to employers for all re-employment assistance benefits (RAB) paid by the state. Employers failing to meet the standards of corporate responsibility established in the Mature Industries Act social compact, M.G.L. c. 149 s 182, would be required to reimburse the state for all supplemental unemployment benefits provided by the state. Under the Mature Industries Act, all employers of 50 or more workers are expected to give the Department of Employment and Training (DET) and their workers 90 days notice of a covered plant closing (defined as a 90% reduction in workforce over 6 months) or of a covered partial closing as defined by regulation. If an employer fails to give 90 days notice, the state pays each affected employee RAB benefits as a supplement to his/her unemployment compensation for each day, up to 13 weeks, that the employee did not receive notice. While this system provides workers with added security while looking for new work, it provides no incentive for employers to give their workers notice. In fact, there is concern that this system in fact creates incentives for not giving notice where employers want to maximize monetary benefits to their workers without having to pay for them. The Executive Office of Administration and Finance (A&F) and House and Senate Ways and Means have all expressed concern over rising RAB costs to the state and the lack of incentives for employers to give notice. A&F estimates a 100% employer chargeback of RAB benefits would cost, on average, approximately 3 weeks of payroll or about 24% of the cost of carrying the payroll for the 3-month pre-notification period.

The second "chargeback" model is in fact more along the lines of a security deposit. As suggested by John Cogan, employers who gain control through a hostile takeover and, perhaps, a leveraged buyout, would be required to place funds in state control adequate to offset the state's costs for RAB benefits and job retraining. If layoffs did not occur within a two-year period, the firm would be entitled to a refund of the monies paid or of a pro rata share of those funds based on the percentage of Massachusetts employees laid off compared to the size of the Massachusetts workforce at the time of the takeover or leveraged buyout. Based on A&F calculations and ISP cost experience ($1,800/client) for worker assistance centers, this proposal would cost employers approximately 3 weeks payroll plus $1,800 per employee as an up front security deposit against possible dislocations over the next two year years.

An elaboration on Mr. Cogan's proposal would require that following any transfer in control, whether by merger, acquisition or leveraged buyout, the new employer would have the following choices: 1) establish a trust which would cover potential RAB and ISP costs for every employee (3 weeks payroll plus $1,800 per employee); 2) file a worker/community impact statement with anticipated layoffs/closings and establish a trust to cover 50% of the potential RAB and ISP costs for each affected employee with the understanding that there would be a 150% chargeback for each underestimate; 3) option (2) with fund established to include expanded employment and training benefits for employees or to include additional benefits for other stakeholders. Under M.G.L. c. 151A, s __, employers have 60? days to notify DET* of a transfer of control, defined to include mergers, acquisitions or leveraged buyouts. This provision could be amended to require new management to file the information required to establish the type of trust it opts for. Options (2) or (3) would require almost infinite freedom to amend the initial disclosure form to accommodate changes in plans that may legitimately result from any of a variety of unforeseen occurrences. Such amendments should be welcomed as long as they occur at least 90 days before a layoff or closing. If the 90 day notice period is not met the 150% chargeback rate kicks in. This provides a double incentive for early notice: 1) the discount rate for planned layoffs; and 2) a penalty rate for unplanned and/or unannounced layoffs.

*This proposal has been discussed as if DET would implement it because of DET's central role in the current plant closing system, it's easy access to information re transfers of control under existing law and staff familiarity with DET enabling legislation. The Department of Revenue and the Secretary of State's Office, Corporations Division have access to similar information re transfers of corporate control and, therefore, could also be considered for the implementation of such a proposal. Other relevant factors in such a choice include administrative capacity to collect, manage and refund "trust" monies and the relation the relevant programs.

Specific discount/late payment rates have been arbitrarily selected to simplify discussion. Clearly, there are a wide variety of embellishments on this final proposal such as how "trust" monies should be invested and who gets the income.

In light of recent enactment of federal legislation requiring mandatory 60 day notice of a layoff of 33% of the workforce or 500 full time employees, it has been proposed that the provisions of the social compact be made mandatory so that all employers would be required to provide 90 days notice or 90 days severance pay in the event of a plant closing or layoff. Despite its support for mandatory notice at the federal level, the Dukakis Administration has opposed a mandatory plant closing notice requirement at the state level in the past because it would place Massachusetts businesses at a competitive disadvantage. Further research would be required to determine what notice requirements would be practical in light of competitive and business climate concerns.

The recommendations that follow are not necessarily mutually exclusive. If a "security deposit" model were used for cases where there had been a transfer of control, some form of "after-the-fact" chargeback would be required to ensure reimbursement of all RAB expenditures by the state and equitable treatment of firms that require use of the state income maintenance and employment and training systems. Each of the recommendations could be modified to expand services covered and/or to modify the definition of who would be eligible for RAB benefits.

<u>RECOMMENDATION A</u>:

The "after-the-fact" RAB chargeback proposal with management responsible for reimbursing the state for all RAB benefits paid to employees dislocated without the full 90 day notice required by the social compact. This recommendation could be expanded to include all state funded program monies used for worker relocation projects and/or to expand the definition of RAB-eligibility.

PROS:

Creates incentives for all firms to provide employees with maximum notice of plant closings or layoffs by requiring the equivalent of severance pay for failure to provide such notice.

Makes no distinction between firms based on the cause of dislocation, whether from merger, hostile takeover, restructuring or leveraged buyout.

Makes no distinction between domestic and "raider" management.

Reimburses state for costs associated with facilitating/expediting dislocated worker transition thereby increasing its capacity to minimize the negative effects of such disruptions on workers and communities.

May create disincentives to "bust-up" takeovers where control premium funded largely through transfer payments from employees by requiring buyer to factor social costs associated realizing such profits into the deal from the outset.

CONS:

"After-the-fact" charge difficult to collect if firm goes bankrupt.

May marginally increase costs to employer of adopting labor-saving process technologies which enhance productivity and competitiveness.

May undermine whatever efficiency producing effects a takeover might have by raising the costs to buyer of implementing new strategies with employment impacts.

Use of RAB-eligibility standard underestimates social costs associated with dislocation since approximately 1/3 of the Massachusetts workforce is not RAB-eligible because they work in firms with fewer than 50 employees.

Could further weaken a company put into play but not taken over since current management would have to pay chargebacks.

RECOMMENDATION B:

Require employer who gain control through either a hostile takeover or an leveraged buyout to set aside in trust under state control monies adequate to offset state costs associated with unemployment benefits and job retraining. If there had been no layoffs within 2 years of the takeover or leveraged buyout, the funds would be returned to the company.

PROS:

Forces new management to assume social costs of transfer of control and, therefore, to factor them into the original transaction creating disincentives to bust-ups done purely for financial profit.

Forces LBO to more carefully evaluate the cost effectiveness of the deal.

Up-front payment substantially increases likelihood that state will receive reimbursement.

Control transfer information that would trigger "security deposit" requirement currently filed with the Department of Employment and Training and the Department of Revenue with criminal penalties for failure to report.

CONS:

Holds managements who gain control through a hostile takeover or leveraged buyout to a different standard of conduct than incumbent managements, with no clear empirical evidence that there is a difference in the use of state re-employment resources across the two groups. [There may well be but we have no real data on this as of this briefing.]

By increasing the transaction cost, current cost plus "social costs," could have perverse effect of increasing leveraging and/or number of layoffs/closings required in the end.

May make an LBO virtually impossible without state support or a degree of leverage that would contribute to instability and long-term dislocations, placing substantial political pressure on the state to underwrite leveraged buyouts.

Loss of use by firm of "security deposit" could pose problems to success of new venture during critical period, following takeover or leveraged buyout, particularly for firms with large numbers of employees.

Potential risk to firm re loss of control over confidential business plans, strategies and information.

Would require expansion of existing administrative capacity to collect, monitor and return "trust" monies.

<u>RECOMMENDATION C</u>:

Require that following a transfer in control, by whatever means, the "new" employer select among the following options:

1) establish trust fund to cover all potential RAB and ISP costs for every employee; or

2) file worker/community impact statement with anticipated layoffs/closings and establish trust to cover 50% of the potential RAB and ISP costs for each affected employee with the understanding that there would be a 150% chargeback for each underestimate.

The expanded version of this could follow the same model but include a broader array of services in the chargeback formula to cover the social costs of other stakeholder dislocations.

PROS:

Same as (B) with the following additions:

Enhanced incentives for "new" employer to do the long-range planning required to take advantage of option (2) at the discount rate, increasing the likelihood that the social costs will be factored into the original transaction providing marginal disincentives to "bust-up" takeovers and non-cost-effective leveraged buyouts.

Through liberal amendment provisions, ongoing contact with the state "dislocation" programs which may have a greater opportunity to minimize potential dislocations before they happen and at the very least to better plan how to respond effectively with advanced notice.

Potentially lower compliance costs for firms choosing option (2).

CONS:

Same as (B) with the following changes:

The perverse affects re increased transaction costs mentioned above should be reduced somewhat for firms choosing option (2).

<u>**RECOMMENDATION D**</u>:

Require all employers to provide 90 days notice or equivalent severance benefits calculated using same formula as RAB benefits for any closing that would be covered by the plant closing definition (90% or more of workforce within 6 months in firm of 50 or more). Other formulae and/or definitions could be developed.

PROS:

Would avoid any need for direct state involvement in the plant closing notice/benefits issue other than that of enforcement at request of employees denied the statutory minimum.

Increased benefits would increase incentives to provide notice in order to avoid paying severance.

Expanded coverage to firms with fewer than 50 employees would extend standard to the almost 93% of Massachusetts firms in this category, increasing likelihood that the 1/3 of the workforce employed in small businesses would get adequate notice/benefits.

CONS:

Enforcement actions generally assume that the aggrieved employee is out of work without adequate benefits until the dispute is resolved.

Could create disincentives for firms to provide anything more than the statutory minimum notice/benefits.

Expanded benefits increase the costs of doing business in the state with associated concerns re business climate, with a disproportionate impact on small and growing businesses which usually have the most critical cash flow problems as well as the greatest job creation potential and highest turnover rate.

This proposal would amend the core provision of the Mature Industries Act, the social compact, which reflects a consensus reached by business, labor, academia and the public sector about what constituted responsible corporate behavior in light of the characteristics of Massachusetts labor markets, likely duration of unemployment, etc. The other proposals do not question these basic assumptions but deal in a more limited fashion with funding sources.

The Commonwealth of Massachusetts
Executive Office of Labor
One Ashburton Place Room 2112
Boston, MA 02108

MICHAEL S. DUKAKIS
GOVERNOR
PAUL J. EUSTACE
SECRETARY

MEMORANDUM

TO: Takeover Commission Members

FROM: Paul J. Eustace, Secretary of Labor
Joseph Alviani, Secretary of Economic Affairs

RE: Workforce Proposals

DATE: 11/2/88

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1. CHARGEBACK PROPOSALS

RAB chargeback: Reemployment Assistance Benefits (RAB) were established under the Mature Industries Act of 1984. These benefits supplement the regular unemployment benefit of 66% of pay received by those qualified laid off employees. RAB benefits provide an income supplement to employees laid off in a certified plant closing or mass layoff, without notice, from a company with a workforce of 50 employees or more. RAB benefits raise UI payments from 66% of pay to 75% of pay for a maximum period of 13 weeks.

What follows are figures on RAB benefits paid out from January 1986 through June 1988.

Fiscal Year	People Collecting	Average Benefit Amt	Average Duration
FY 86 (half year only from 1/86-6/86)	4644	$77.17	11.3 weeks
FY 87	5230	$77.48	9.8 weeks
FY 88	7577	$78.63	10.5 weeks

The proposal to the Commission is to make this an experience-rated program, paid by those employers whose employees collect RAB instead of being paid out of general state revenues. This proposal has already received support from the Governor and House and Senate Ways and Means Committees.

Training Chargeback: Currently, the costs of placement, counseling, and retraining are paid for with state and federal funds. At least a portion of this should be paid for by a company laying off its employees.

The current cost estimates are as follows:

$1800/client for cost of establishing worker assistance center which provides counseling, placement and referrals; (additional training costs are generally paid for with federal funds)

$ 370/client for DET service program and administrative costs

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$2170/client TOTAL

The proposal before the Commission is to recommend that employers pay all or a proportion of these placement and training costs.

The attached chart provides several examples of projected costs for these chargeback provisions.

2. A TIN PARACHUTE

The proposal is that the Commission recommend a requirement that an employer who offers "golden parachutes" to an owner or member of senior management must provide "tin parachutes" to other employees, management and non-management. A golden parachute is any cash payment, benefit such as pension benefits, or stock ownership above the usual annual salary and benefit package provided senior management paid out in the event of a termination or resignation. If a company policy is in effect that would provide these benefits to senior management or has been in effect within the previous two year period, the company must provide a parallel benefit to other employees in the form of two weeks severance pay for every year of employment service.

The attached chart provides examples of cost estimates.

3. LABOR STANDARD

The proposal is that the Commission recommend that state labor standards be amended to require that acquisitors of businesses operating in Massachusetts maintain for one year the wages and benefits of employees at no less than the level they were at the time of purchase.

This is an attempt to provide a cushion period for employees after a buyout. Where a collective bargaining agreement is in effect, it will not inhibit negotiations but only establish a minimum labor standard for wages and benefits for the one year after purchase.

Examples of wage cuts in Massachusetts companies after buyouts and the cost estimates of this proposal which would have been prohibited during the first year of purchase are included below:

> Greenfield Tap & Dye: 320 non-management employees received $3.40/hour cut after buyout; total savings to employer/cost to employees = $2,263,040/year. (There have been additional, less measurable costs to employer due to roughly 50% turnover rate since these provisions were put in place.)
>
> Simond Cutting: 285 employees with $2.00/hour wage cut; savings to company/cost to employees = $1,185,600/year.

4. <u>FEDERAL ASSUMPTION OF COLLECTIVE BARGAINING AGREEMENTS</u>

The Commission should recommend that Congress amend the National Labor Relations Act to require that acquiring companies assume collective bargaining agreements existing at the time of purchase or merger.

RAB AND TRAINING CHARGEBACKS AND SEVERANCE BENEFITS
COST ESTIMATES FOR SAMPLE MASSACHUSETTS CLOSINGS

Company+	Number of Employees (#)	Previous Average Wage ($) (hourly/wkly)	Average Length of Service (years)	RAB Chargeback ($) (13/10.5 wks)*	Training Chargeback ($) (2170/ee)	Severance ($) (2 wks)
Small	60	8.50 340.	25	23,868 19,278	130,200	1,020,000
Medium	250	14.31 572.40	15	167,440 135,240	542,500	4,293,000
Large	900	9.56 382.40	5	402,714 325,269	1,953,000	3,441,600

+These figures are from real Massachusetts company closings not necessarily due to takeover or restructuring activity.

* These estimates assume all employees collect RAB benefits. The 13-week figure assumes collection for full eligibility period; 10.5 for average length of benefits during past 3 years.

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ICHAEL S. DUKAKIS
GOVERNOR
PAUL J. EUSTACE
SECRETARY

MEMORANDUM

TO: Takeover Commission Members

FROM: Paul J. Eustace, Secretary of Labor
Joseph Alviani, Secretary of Economic Affairs

RE: TIN PARACHUTES

DATE: 11/7/88

A TIN PARACHUTE

The proposal is that the Commission recommend a requirement that an employer who offers "golden parachutes" to an owner or member of senior management must provide "tin parachutes" to other employees, management and non-management.

A golden parachute is any cash payment, benefit such as pension benefits, or stock ownership above the usual annual salary and benefit package provided senior management paid out in the event of a termination or resignation. If a company policy is in effect that would provide these benefits to senior management or if a golden parachute has been paid out within a certain period, the company must provide other employees a minimum of two weeks severance pay for every year of employment service.

The intent of this proposal is to establish a principle of equity when it comes to severance packages paid out in the event of takeover and corporate restructurings. Multi-million dollar packages are established for a handful of senior management and paid out in the event of termination, while other employees may be provided no severance coverage. In addition, by adding to the cost of layoffs, this provision would serve as a disincentive for financing buyouts through employee layoffs.

Commission members adopted the following motion:

> The Commission in principle believes that the use of golden parachutes by key management ought, out of a sense of fairness, to require some form of tin parachute for all other employees.

Commission members agree that two areas need further clarification before finalizing this recommendation. First, we must agree upon a definition of golden parachutes. This is especially important in order to avoid unnecessary consequences, for example, inhibiting a company's ability to recruit senior managers or technical experts. Second, the Commission must decide on the event that would trigger the requirement for a tin parachute. Three options were discussed, the advantages and disadvantages of which are outlined below.

The attached chart provides examples of cost estimates.

<u>OPTION ONE:</u>

That the requirement for tin parachutes be triggered once a golden parachute has actually been paid out to a previous owner or senior management as a result of a change in ownership. The requirement to pay a tin parachute could be made retroactive for those laid off within a specified period prior to the golden parachute payment. For example January 1, 1990, a senior manager is laid off and paid a golden parachute. The company is required to pay tin parachutes retroactively to any employee who did not receive a severance package at least equivalent to the minimum standard but was laid off during the previous year, on or after January 1, 1989. The company is also required to pay a tin parachute for anyone laid off during the following two years, through December 31, 1991.

PROS:

This ties the payment of tin parachutes most directly to the payment of golden parachutes and to a change in ownership.

CONS:

The requirement to pay tin parachutes could be avoided by laying off employees first, waiting a year, and then laying off a senior manager eligible for a golden parachute.

It may be difficult to track down employees for payment of tin parachutes retroactively.

An employee may not know if they are eligible for a tin parachute at the time laid off, when they are most likely to need financial resources.

OPTION TWO:

A company that has a golden parachute policy for one or more employees and is put in play must establish a tin parachute policy that meets the minimum requirement--two weeks of pay for each year of employment--for all other employees

PROS:

This proposal establishes the fairness principal for severance packages. Where senior staff are covered during a corporate restructuring or takeover, other employees must be covered by a minimum policy.

CONS:

This would require payment of tin parachutes even if payment of a golden parachute were never made.

OPTION THREE:

Where a golden parachute policy is in effect, a company must also have in place a tin parachute policy that would set as a mimimum requirement two weeks of pay for every year of service.

PROS:

This is the broadest framework for this proposal. It covers employees regardless of whether a company actually pays out a golden parachute and regardless of whether a company is a takeover target.

This may limit the use of golden parachutes.

CONS:

This would require payment of tin parachutes even if payment of a golden parachute were never made.

This is the broadest framework for this proposal. It covers employees regardless of whether a company actually pays out a golden parachute and regardless of whether a company is a takeover target.

RAB AND TRAINING CHARGEBACKS AND SEVERANCE BENEFITS
COST ESTIMATES FOR SAMPLE MASSACHUSETTS CLOSINGS

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* These estimates assume all employees collect RAB benefits. The 13-week figure assumes collection for full eligibility period; 10.5 for average length of benefits during past 3 years.

The Commonwealth of Massachusetts
Executive Office of Labor
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Boston MA 02108

MICHAEL S DUKAKIS
GOVERNOR
PAUL J EUSTACE
SECRETARY

MEMORANDUM

TO: Commission members

FROM: Paul J. Eustace
Joseph Alviani

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS REGARDING PENSION PROTECTION PROVISIONS

GENERAL PROPOSAL:

Endorse federal legislation that would prevent use of employee pension funds or pension fund surpluses for debt service.

OPTION A:

Endorse federal protections now before Congress.

PRO:

Congress appears close to enacting such federal protections.

Federal action would also avoid the need to address ERISA implications of state legislation.

OPTION B:

Add a proviso that should federal action not be taken by the end of 1989, the Governor would support state legislation.

OPTION C:

Should federal action not be taken soon, propose that the state pension funds cannot be invested in any company that has not secured their own employees' pension rights.

PRO:

This makes a stronger statement endorsing this principle.

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MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

MEMORANDUM

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: AFL-CIO PROPOSALS FOR SEVERANCE/CONTINUED HEALTH BENEFITS AND FOR PROHIBITION OF SALES OF REAL ESTATE FOLLOWING A HOSTILE TAKEOVER

GENERAL PROPOSAL:

Prohibit use of corporate real estate located in Massachusetts as a source of financing for a control transfer transaction and require target to pay severance to each employee terminated within two years after commencement of a takeover bid.

BACKGROUND:

Soon after legislation was filed to clarify the fiduciary duties of corporate directors to permit them to consider stakeholder interests in determining the best interests of the corporation and its shareholders (S. 1502/H. 4741), the United Food and Commercial Workers Union, Local 1459 and the Massachusetts AFL-CIO proposed two amendments to accomplish the following:

1) prohibit the use of corporate real estate located in Massachusetts as a source, direct or indirect, of financing a stock purchase in that firm or a shareholder dividend or distribution above the historical average for the corporation; and

2) require a target company to pay one-time, lump sum severance benefits of 4 weeks pay for each completed year of service to each employee laid off within two years of the commencement of a takeover bid.

The House and Senate Chairs of Commerce and Labor referred these bills to the Commission for evaluation in the broader context of its overall mandate given their potential impacts on capital and labor mobility and the fundamental changes they represent in the present dislocated worker system created under the Mature Industries Act and their possible effects on business climate and the competitiveness of Massachusetts businesses and, therefore, long-term economic growth and job creation. (please see attached).

These proposals resemble, in a number of ways, other proposals currently being considered by the Commission. Aspects of the real estate transfer prohibition would be a central component in any business combination proposal. The severance benefit proposal is a more comprehensive and expensive version of the "security deposit" chargeback model. However, unlike the various chargeback proposals, it represents a fundamental modification of the consensus around which the Mature Industries Act was developed, i.e. the voluntary notice provision of the social compact, M.G.L. c. 149, s 182.

RECOMMENDATION A:

Prohibit use of any interest of corporate real estate located in Massachusetts for the financing of a transaction for change or corporate control.

PROS:

If effective, it could deter bust-up takeovers, reducing the probability and/or severity of worker/community dislocation by preventing a company from encumbering/disposing of its own assets to finance a prior change in control.

There is no discrimination between new and incumbent managements or foreign and domestic corporations.

It makes no attempt to prevent a transfer of control.

Possibly constitutional as a legitimate exercise of state authority to regulate the disposition of real property within its borders.

CONS:

It would not prevent a corporation from milking and/or encumbering/disposing of all non-real assets with same end result as bust-up.

Appears to be very narrowly focused on those firms/industries for which real estate is the principal corporate asset, e.g., retail chains.

It would appear to prevent most leveraged buyouts unless they could be completely financed with other corporate assets.

Could represent an unconstitutional interference in the corporations rights to dispose of its assets.

RECOMMENDATION B:

Mandatory lump-sum payment by target of 4 weeks severance pay for each year of service completed if an employee is involuntarily terminated within two years after a party acquires a 10% interest in the target or takes control of its board.

PROS:

Creates disincentives to any actual transfer of control by increasing the price to the buyer, as do excessive golden parachutes.

CONS:

By increasing the transaction price, it could increase the amount of target assets that would be sold off to pay severance benefits.

Could serve to further destabilize a firm put in play with a 10% stock purchase by requiring severance payments for all subsequent involuntary terminations which would have to be paid by target.

Could encourage layoffs through defensive restructurings to avoid severance requirement.

Creates significant inequities in the treatment of dislocated workers based on the cause of the layoff which is often difficult to determine.

Creates further inequities among workers who are involuntarily terminated (and ordinarily eligible only for unemployment insurance) because of the implicit assumption that all involuntary terminations following a takeover attempt are the result of that attempt.

Creates strong incentives for management to pressure workers to "volunteer" for early retirement.

Raises concerns re business climate and the competitiveness of Massachusetts businesses and, therefore, long-term economic growth and future job creation.

RECOMMENDATION C:

Incorporate the intent of these proposals, added protection to workers in takeover-related dislocations, into proposals for business combination law, chargeback set asides and review of the notice/benefit provisions of the social compact.

PROS:

Provides more comprehensive and equitable protections for employees and other stakeholders who may suffer dislocations as the result of takeover-related activities.

CONS:

See CONS for individual proposals re business combination laws and chargeback/set asides.

A proposed amendment to G.L. c.110C by inserting a new section______

Offered by the United Food and Commercial Workers Union, Local 1459, AFL-CIO and the Massachusetts Federation of Labor, AFL-CIO.

AN ACT TO PROVIDE SEVERANCE PAY
IN THE EVENT OF TERMINATION OF EMPLOYMENT
FOLLOWING TAKE-OVER BIDS

Each employee of a target company shall be entitled in the event of his or her termination of employment within two (2) years following the date of commencement of a take-over bid to a one-time lump sum payment from the target company equal to the product of four(4) times his or her weekly compensation for each completed year of service. The severance pay to eligible employees shall be in addition of any final wage payment to the employee and shall be made within one regular pay period after the employee's last day of work.

For the purposes of this section:

1. "Termination of employment" shall mean the involuntary termination of an employee's employment for any reason but not including his or her retirement, permanent or total disability, or death.

2. "Take-over bid", the definition contained in section one of this chapter excluding cl.(4)

3. "Weekly compensation" shall mean such person's base compensation in effect on the last payroll period ending prior to the date of the Change of Control Event.

4. "Year of service" shall include each full year during which such person has been employed by the target company, prior to his or her termination of employment.

5. There shall be no liability for the one-time payment to an eligible employee if:

A. The employee is covered by an express contract providing for such payment in the event of termination of employment in excess of that provided in this section.

B. The employee has been employed by the target company for less than three years.

6. Any employee who does not receive the lump-sum payment described in paragraph one of this section may institute and prosecute in his own name an action for the amounts due him in the superior court. Any aggrieved person or persons who prevail in such an action shall be entitled to an award of the costs of the litigation and reasonable attorneys' fees to be fixed by the court.

A proposed Amendment to G.L. c.110C by inserting a new section ________

Offered by the United Food and Commercial Workers Union, Local 1459, AFL-CIO and the Massachusetts Federation of Labor, AFL-CIO

AN ACT TO REGULATE INTERESTS
<u>IN REAL PROPERTY RELATED TO TAKE-OVER BIDS</u>

Section 1. No interest in real property located in the Commonwealth and owned by a domestic or foreign corporation, or the corporation's parent or one or more of the corporation's subsidiaries, may be sold, mortgaged, pledged, hypothecated, or encumbered where any of the proceeds of such a transaction are or are intended to be used to finance:

(a) Purchase of stock in the corporation by a person seeking control of the corporation; or

(b) Payment to shareholders of a dividend or other distribution larger than the historical average for the corporation.

Section 2. Definitions--

(a) "Owned" means a legal, beneficial or possessory interest.

(b) A "parent" of a corporation is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

(c) A "subsidiary" of a corporation is an affiliate controlled by such corporation directly, or indirectly, through one or more intermediaries.

(d) An "affiliate" is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or in under common control with, the person specified.

(e) An "associate" of a person means (1) any corporation or organization of which the person is an officer or partner or is, directly or indirectly, the beneficial owner of ten percent or more of any class of equity securities; (2) any trust or other estate in which the person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (3) any relative or spouse of the person, or any relative of such spouse, who has the same home as such person.

(f) "Person seeking control" means any person, including the affiliates and associates of such person, who acquires directly or indirectly the beneficial ownership of more than ten percent of any class of the corporation's securities.

(g) "Historical average" means the average annual dividend during the 5 fiscal years of the corporation immediately preceding the fiscal year in which the sale, mortgage, pledge, hypothecation or other encumbrance is consummated.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: CLARIFICATION OF FIDUCIARY DUTIES OF CORPORATE DIRECTORS

GENERAL PROPOSAL:

Clarify the fiduciary duties of corporate directors by amending M.G.L. c. 156B, s 65 to explicitly state that in determining what a director "...reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors, and customers; the economy of the state, region and nation; community and societal consideration; and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may best be served by the continued independence of the corporation."

BACKGROUND:

Legislation incorporating this proposal has been filed by the Administration (H. 4741) and by Senator Pines (S. 1502) and is currently before the Joint Committee on Commerce and Labor which is waiting for a recommendation of this Commission before deciding whether it will report these bills out favorably or unfavorably.

Both bills were filed to clarify the existing fiduciary standard for corporate directors and was not intended to change that standard. It makes clear that directors are not limited under the business judgment rule to making decisions based exclusively on the short-term, financial interests of the corporation and its shareholders. Directors may base their decisions on long-term considerations and the broader issues relating to the impact of specific corporate decisions on stakeholders. By clarify existing law, this proposal is intended

to provide a counterbalance to the concrete pressures directors face in the form of shareholder suits. Similar language has been adopted by 17 other states including [insert list]. The sponsors of S. 1502 and H. 4741 considered and rejected a suggestion that directors be required to consider the impact of their decisions on stakeholders on the basis that such a requirement created the potential for director liability to stakeholders for failing to adequately consider their interests. The option of relieving directors of liability to stakeholders was also rejected. S. 1502 and H.4741, as filed, received strong support in the public hearings held by the Committee on Commerce and Labor. The United Shareholders of America was the only group to testify in opposition on the basis that consideration of interests other than those of shareholders enables management to entrench itself by evaluating interests that do not accurately measure productivity and efficiency. Basically, they argued the efficient market hypothesis, what's best for stockholders is best for the economy.

RECOMMENDATION A:

Support S. 1502 and H. 4741 as filed.

PROS:

It encourages directors to consider interests other than the short-term, financial interests of the corporation and its shareholders by providing a legal framework within which directors can be secure that the consideration of such interests will not leave them open to shareholder suits.

It could give the board greater leverage in negotiating the terms and conditions of any transfer of control.

CONS:

It does not require that stakeholder interests be considered nor does it give stakeholders a role in the decision-making process absent some form of stakeholder representation on the board.

Absent sufficient disclosure and adequate time to evaluate information it may not be possible for directors to effectively consider stakeholder rights. [see disclosure and antitrust proposals]

RECOMMENDATION B:

Require directors to consider stakeholder interests as a condition to eligibility for added takeover protections through a business combination or other type of statute with (or without) express

language that the consideration of stakeholder interests does not create an implied right of action. [This could be a component of a Reich-type proposal]

PROS:

Creates incentives for directors of corporations that feel threatened by takeovers to consider stakeholder interests. The result is self-identification of firm "at risk" where stakeholders have the greatest investment in having their interests considered.

Mandatory consideration of stakeholders may encourage board action to develop information base needed to effectively evaluate the impact of decisions on various stakeholder interests.

CONS:

May create a disincentive to firms that would otherwise seek the added protection of a business disclosure statute (to the benefit of stakeholders) from electing such protection due to uncertainties re potential liability and/or enforcement.

Absent sufficient disclosure and adequate time to evaluate information it may not be possible for directors to effectively consider stakeholder rights.

Absent an implied right of action who would enforce such standard?

<u>RECOMMENDATION C</u>:

Require raiders to consider stakeholder interests as a condition for avoiding the business combination prohibition along the Connecticut model.

PROS:

Requires raiders (which are presumed to have the least investment in and commitment to existing stakeholders) to consider their interests before entering into any business combinations.

CONS:

Treats raider management differently from incumbent or friendly management by requiring them to adhere to a higher standard of care for stakeholder interests than required of other management teams within Massachusetts.

Raises questions of inequity in treatment across different stakeholder groups based solely on the "hostility" of the takeover rather than on the degree of stakeholder risk, particularly significant in context of LBOs.

RECOMMENDATION D:

Make authorization by a coporate board director of the payment of greenmail to a hostile bidder a per se violation of his/her fiduciary duty to the corporation and its shareholders.

PROS:

Sends a very clear message to both directors and potential bidders about the possiblity of using greenamil as a negotiating tool in the takeover context which could provide significant disincentivies to parties who put a firm in play to benefit from stock price increases or any other source of income but really have no intention of taking the company over.

Protects shareholders from short-term reductions in stock price associated with greenmail payments and from long-term losses caused by weakening of the corporation if greenmail is repeatedly paid.

CONS:

Prohibits corporations from using what may in some instances be the only effective defensive tactic available to them.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR

JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: September 28, 1988

RE: CLARIFICATION OF FIDUCIARY DUTIES OF CORPORATE DIRECTORS - # 2

GENERAL PROPOSAL:

Clarify the fiduciary duties of corporate directors by amending M.G.L. c. 156B, s 65 to explicitly state that in determining what a director "...reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors, and customers; the economy of the state, region and nation; community and societal consideration; and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may best be served by the continued independence of the corporation."

BACKGROUND:

The discussion surrounding this proposal at the August 31 Commission meeting reflected a general consensus among the members that the proposal should be included as one of the Commission's recommendations. However, Mr. Resnick raised a question about adding language to the proposal found in S. 1502 and H. 4741 to explicitly relieve corporate directors that consider stakeholder interests from any liability flowing from such consideration. This suggestion, in turn, led to alternate suggestions to cap director liability when stakeholder interests are considered and/or to require that minutes adequately reflect consideration of stakeholder interests.

After further consideration, Mr. Resnick informed us that he was satisfied that the language in S. 1502 and H. 4741 adequately protected directors from potential liability flowing from the consideration of stakeholder interests. In addition, he felt that any

attempts to draft language defining a standard for what constitutes "adequate" consideration of such interests could easily cause more problems than it would solve.

<u>RECOMMENDATION A</u>:

Support S. 1502 and H. 4741 as filed.

PROS:

It encourages directors to consider interests other than the short-term, financial interests of the corporation and its shareholders by providing a legal framework within which directors can be secure that the consideration of such interests will not leave them open to shareholder suits.

It could give the board greater leverage in negotiating the terms and conditions of any transfer of control.

CONS:

It does not require that stakeholder interests be considered nor does it give stakeholders a role in the decision-making process absent some form of stakeholder representation on the board.

Absent sufficient disclosure and adequate time to evaluate information it may not be possible for directors to effectively consider stakeholder rights. [see disclosure and antitrust proposals]

SENATE . . . . No. 1502

By Ms. Pines, a petition (accompanied by bill, Senate, No. 1502) of Lois G. Pines, Marilyn L. Travinski, Frances L. Alexander and Suzanne M. Bump for legislation to clarify the responsibilities of corporate directors. Commerce and Labor.

The Commonwealth of Massachusetts

In the Year One Thousand Nine Hundred and Eighty-Eight.

AN ACT CLARIFYING THE RESPONSIBILITIES OF CORPORATE DIRECTORS.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. Section 65 of Chapter 156B of the General Laws, as appearing in the 1986 Official Edition, is hereby amended by inserting, in line 6, after the first sentence, the following sentence: — In determining what he reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers; the economy of the state, region and nation; community and societal considerations; and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

SECTION 2. The provisions of this Act shall apply to all acts of corporate directors occurring on or after February eighth, nineteen hundred and eighty-eight.

HOUSE . . . . No. 4741

The Commonwealth of Massachusetts

THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE DEPARTMENT
STATE HOUSE · BOSTON 02133

EVELYN F. MURPHY
LIEUTENANT GOVERNOR

ROOM 259
(617) 727-7200

February 8, 1988

TO the Honorable Senate and House of Representatives:

This proposed amendment to Section 65 of Chapter 156B of the General Laws clarifies the responsibilities of corporate directors. It makes clear that a corporate director is not required to act solely on the narrow and short term interests of the corporation and its shareholders. Indeed, the corporation's continued independence and the impact on its employees, the state and national economy and larger community and societal interests may be considerations which play a part in a corporate director's decision. This amendment would explicitly afford a director this broad discretion.

I respectfully urge its prompt passage.

Respectfully submitted,

Evelyn F. Murphy
Acting Governor

The Commonwealth of Massachusetts

In the Year One Thousand Nine Hundred and Eighty-Eight.

AN ACT CLARIFYING THE RESPONSIBILITIES OF CORPORATE DIRECTORS.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. Section 65 of Chapter 156B of the General Laws, as appearing in the 1986 Official Edition, is hereby amended by inserting, in line 6, after the first sentence, the following sentence: — In determining what he reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors, and customers; the economy of the state, region and nation; community and societal considerations; and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

SECTION 2. The provisions of this Act shall apply to all acts of corporate directors occurring on or after February eighth, nineteen hundred and eighty-eight.

156B:65. Limitation on Imposition of Liability Under Secs. 60—64.

Section 65. A director, officer or incorporator of a corporation shall perform his duties as such, including, in the case of a director, his duties as a member of a committee of the board upon which he may serve, in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances. In performing his duties, a director, officer, or incorporator shall be entitled to rely on information, opinions, reports or records, including financial statements, books of account and other financial records, in each case presented by or prepared by or under the supervision of (1) one or more officers or employees of the corporation whom the director, officer or incorporator reasonably believes to be reliable and competent in the matters presented, or (2) counsel, public accountants or other persons as to matters which the director, officer or incorporator reasonably believes to be within such person's professional or expert competence, or (3) in the case of a director, a duly constituted committee of the board upon which he does not serve, as to matters within its delegated authority, which committee the director reasonably believes to merit confidence, but he shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause such reliance to be unwarranted. The fact that a director, officer or incorporator so performed his duties shall be a complete defense to any claim asserted against him, whether under sections sixty to sixty-four, inclusive, or otherwise, expect as expressly provided by statute, by reason of his being or having been a director, officer or incorporator of the corporation.

Charles H Resnick
Senior Vice President
Secretary and
General Counsel

Raytheon Company
141 Spring Street
Lexington MA 02173

617 860 2545

Raytheon

September 13, 1988
88-529R

The Honorable Joseph D. Alviani
Secretary of Economic Affairs
Commonwealth of Massachusetts
One Ashburton Place - Room 2101
Boston, Massachusetts 02108

Dear Secretary Alviani:

Re: Commission to Review Massachusetts
Anti-takeover Laws

At the September 7 meeting of the Commission, I supported legislation filed by Senator Pines and others (S. 1502 and H. 4741) authorizing directors to consider employment, community and other long-term interests of a corporation in making their decisions. At the time, I suggested clarification to assure that directors who take such factors into account are relieved of liability and volunteered to draft appropriate language for that purpose.

After rereading Chapter 156B, Section 65, I am satisfied that the final sentence in the Section already covers the subject and alleviates my concern. I, therefore, support Senator Pines' bill without change.

A suggestion was also made at the meeting that there be a requirement that board minutes reflect the considerations. After trying a couple of drafts, I have concluded that such a requirement probably would do more harm than good. What we want is the fact of consideration of other constituencies -- not simply the record without the consideration.

Sincerely,

Charles R

CHR:lap

CC: The Honorable Lois G. Pines
Senate Chair
Joint Committee on Commerce and Labor

Ms. Barbara Waters

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
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(617) 727-8380

MEMORANDUM

TO: Members of the Commission to Review Massachusetts Anti-Takeover Laws

FROM: Joseph D. Alviani - co-chair
Paul J. Eustace - co-chair

DATE: March 3, 1988

RE: MASSACHUSETTS ANTI-TAKEOVER LAWS - A SUMMARY

The competitiveness and growth of the American economy, and the well-being of our citizens, depend on long-term investments in physical plant, research and development and worker training and re-training to increase productivity. While hostile takeovers are not a new phenomenon, their significance in shaping corporate strategic planning and the operation of financial markets has substantially increased over the past two decades. Now even the largest American firms consider themselves vulnerable to takeover attempts. Takeovers can be important and useful mechanisms for transferring corporate control, thus ensuring management accountability, or they can be efficient mechanisms for short-term financial speculation. Either way, successful takeovers and takeover attempts are often followed by major organizational changes for the target, resulting in shifts in management, layoffs and reduced investments in areas critical to long-term competitiveness. The prospect of such changes, combined with perceived abuses on Wall Street and the high level of debt incurred in both takeovers and takeover defenses, have created an environment that encourages states to regulate takeover activities to protect not only shareholder and management investments, but the investment of labor and the public sector in long-term economic growth and job security.

Corporations seeking protection from hostile takeovers first turned to the federal government for help. In response, Congress passed the Williams Act in 1968, designed to provide investors with sufficient information to enable them to act in their own interest, while creating a "level playing field" between targets and bidders by establishing disclosure requirements and procedures for tender offers similar to those for stock mergers or proxy battles. The key provisions of the Williams Act require that offers remain

open at least 20 days after commencement and that acquirers of 5% or more of a company's stock disclose the purpose of the acquisition and source of financing within 10 days of the acquisition. Congress specifically rejected provisions that would have given target managements an advantage over bidders.

Many corporations felt the federal response was inadequate and turned to the states for added protection. By 1982, 37 states, including the Commonwealth, had responded by enacting legislation modeled, for the most part, on the Williams Act but requiring greater disclosure. M.G.L. c. 110C, regulating take-over bids in the acquisition of companies, is based on this model, requiring a person making a tender offer to publicly announce the terms of a proposed takeover bid and file with the Secretary of State and the target company on the date of commencement of the bid. Chapter 110C also authorizes the Secretary of State to hold hearings at the request of the target or its shareholders to determine whether the bid complies with the specific disclosure requirements of the chapter. Some other "first generation" laws also gave states power to rule on the merits of an offer and then prevent it from proceeding. Most "first generation" statutes applied not only to companies incorporated in-state but to "foreign" corporations as well. The result was 37 laws with varying requirements and overlapping jurisdictions. In 1982, in Edgar v. MITE, the U.S. Supreme Court found the Illinois anti-takeover law unconstitutional because it conflicted with the Williams Act by favoring management interests over those of shareholders and because it represented a substantial impediment to interstate commerce. This opinion effective invalidated all 37 of the "first generation" laws. However, the MITE opinion did not hold that all state regulations of takeovers would be unconstitutional. Based on guidelines in the MITE opinion, states began developing the " second generation" of takeover laws, of which there are four basic types.

The principal difference between the two "generations" is that "first generation" laws directly regulated tender offers through state securities laws and "second generation" laws regulate takeovers indirectly through state laws concerning corporate organization and governance which, as yet, have no parallel in federal law. To date only the control share acquisition model, like the Indiana law and the recently enacted Massachusetts Control Share Acquisition Act (M.G.L. cc. 110D & 110E), has been explicitly upheld by the Supreme Court.

The basic Indiana model, which applies only to companies incorporated in-state, establishes threshold proportions of voting power at one-fifth, one third and a majority. If an acquiring entity or bidder acquires shares that would cause its voting power to reach one of these thresholds, the bidder does not automatically acquire the voting rights ordinarily associated with the new shares. The transfer of voting rights must be approved by a majority of the disinterested shareholders, excluding the bidder and inside directors or officers of the target. A bidder who proposes to make or has made an acquisition of shares that would trigger the Indiana Act can request a special shareholders' meeting, which must be held within 50 days of the request. The expenses of the special meeting are borne by the bidder. The requirement for shareholder approval of voting rights does not apply if the acquisition is part of a merger agreement. Opponents of the Indiana model see it as increasing costs and uncertainty. Proponents of the model see it as encouraging long-term productive investment by deterring takeovers undertaken solely for short-term financial profits and for ensuring that shareholders have sufficient time to evaluate the tender offer and act in their best interest and that of the corporation.

The Massachusetts Control Share Acquisition Act differs from the Indiana statute in two significant respects. First, it contains provisions to extend coverage to Massachusetts-based firms incorporated in other states (M.G.L. c. 110E). Second, the Act requires the Governor to report back to the General Court in two years on the long-term effects of the law on the Massachusetts economy and to make any recommendations that may be appropriate in this respect. There is considerable debate over the long-term impact of Indiana-type statutes on capital markets and the productivity/competitiveness of the economy. However, since there has been no effective action at the federal level regulating the abuses and excesses of hostile takeovers, state regulation, at least in the short-run, is necessary to protect the long-term interests of labor, business, shareholders, consumers, suppliers, communities and the state itself. The Massachusetts Control Share Acquisition Act was enacted to respond to this need by deterring takeovers undertaken solely for short-term profits. However, the Massachusetts Act also provides a mechanism for evaluating the longer-term implications of this type of takeover regulation in a rapidly changing financial and regulatory environment. That is the charge of this Commission.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
SECRETARY

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(617) 727-8380

M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani

DATE: August 9, 1988

RE: OPTIONS FOR M.G.L. c 110C, 110D & 110E

This memo is designed simply as a brief discussion of a few of the options the Commission might consider if it chooses to make specific recommendations regarding M.G.L. cc 110C, 110D or 110E. The following is meant to stimulate discussion and does not represent the official position of either the Attorney General, the Secretary of State or the Administration.

M.G.L. c. 110C

Chapter 110C is the Commonwealth's "first generation" takeover law. Basically, it requires that when a person purchases 5% of the outstanding stock of a corporation, he must provide notice to the corporation and the Secretary of State. The Secretary of State is authorized to conduct hearings on the effect of the purchase at the request of the target or independently. Failure to disclose the required information is punishable by a prohibition on further stock purchases, Chapter 110C, Section 3 (the "penalty box" provision). There are currently several problems concerning Chapter 110C:

1. The "penalty box" provision was held unconstitutional by the 1st Circuit in the Hyde Park decision (1988) based on the Supremacy and Commerce Clause arguments developed in Edgar v. MITE Corp., 457 U.S. 624 (1982).

2. The Secretary of State's Office faces substantial problems in obtaining/enforcing subpoenas to obtain information from out-of-state purchasers.

3. The expense and difficulty associated with collecting relevant information, analyzing it and conducting hearings is high given 110C's uncertain constitutional status, leading the Secretary of State to implement the statute only at the request of a target company.

Several options for possible action have been suggested assuming that the Hyde Park Supremacy Clause analysis can be overruled given the differing rationales of Edgar v. MITE (1982) and CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987):

1. Amend 110C to limit its application to domestic corporations or to establish a stronger nexus as was done in 110E (see below) to avoid challenge on Commerce Clause grounds.

2. Re-write the disclosure provisions to require that additional information required by the Secretary of State's Office go to investors to undercut arguments that 110C's primary purpose is to delay rather than protect investors.

3. Amend the "penalty box" provision to substitute substantial monetary fines for the current prohibition on further purchases.

4. Modify the enforcement provisions to give the Securities Division of the Secretary of State's Office the power to levy fines for non-compliance with hearing procedures, including the failure to obey a subpoena issued in a proceeding. This might effectively address the out-of-state subpoena problem, at least as it relates to the production of documents. Personal appearances of parties would still present a problem given the short time frame required by the Act.

5. Time frames could be modified to match those of the Williams Act.

M.G.L. c. 110D

Chapter 110D is the Control Share Acquisition Law enacted in July 1987 as it applies to domestic corporations. The principle issues relating to 110D concern its effectiveness rather than its constitutionality. The general sense appears to be that it may be effective in extending the amount of time a target might have to evaluate and respond to an unsolicited offer and, perhaps, at the margin increase the offer price. The principle concern raised has been the use of 110D by an under-financed bidder to put a company in play to use the special shareholder meeting requirement as a mechanism to get control. The result has been that many/most Massachusetts firms have opted out of 110D coverage understanding that they may opt back in at any time.

M.G.L. c. 110E

Chapter 110E is the Control Share Acquisition Law enacted in July 1987 as it applies to foreign corporations. There are basically two problems:

1. A virtually identical Oklahoma statute was held to be an unconstitutional burden on interstate commerce in TLX Acquisition Corp. v. Telex Corp., (W.D. Okla. Nov. 3, 1987) [For an opposing viewpoint see attached brief written by Martin Lipton.]

2. The new SEC Rule concerning voting rights, 19c-4, would result in the delisting of the common stock of a corporation that invoked 110E as a protection.

The above options have been included in this briefing as illustrations to stimulate discussion. While amendments to 110C may cure constitutional infirmities, it remains unclear whether such amendments would result in a statute which would further the intent of the Commission. Similarly, if the Telex decision is overturned at some point in the future, absent a reinterpretation of the new SEC Rule 19c-4, it may not be a valuable option.

I would like to thank Barry Guthary and Carl Valvo for their assistance.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
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MICHAEL S. DUKAKIS
GOVERNOR

JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS RE M.G.L. c. 110C, 110D AND 110E

GENERAL PROPOSAL(S):

Recommend any or all of the "technical" amendments described below to increase the effectiveness and constitutionality (in some cases) of existing Massachusetts takeover statutes.

BACKGROUND:

One of the principal charges to the Commission has been to evaluate the effects of the Massachusetts Control Share Acquisition Act and other related statutes on the economic well-being of the Commonwealth and to make recommendations, where needed, for their modification to ensure the long-term economic well-being of the Commonwealth's citizens. What follows are a series of "technical" amendments to M.G.L. c. 110C, 110D & 110E designed to address a series of specific problems that have emerged since enactment of these laws. In reviewing the effectiveness of these statutes, the Commission may wish to consider what, if any, additional business entities should be covered by their protections/requirements. At present, their applicability is limited to 156B corporations. However, proposals to extend coverage to banks and other corporate entities have been made in the past.

M.G.L. c. 110C

Chapter 110C is the Commonwealth's "first generation" takeover law. Basically, it requires that when a person purchases 5% of the outstanding stock of a corporation, he must provide notice to the corporation and the Secretary of State. The Secretary of State is authorized to conduct hearings on the effect of the purchase at the request of the target or independently. Failure to disclose the

required information is punishable by a prohibition on further stock purchases, Chapter 110C, Section 3 (the "penalty box" provision). There are currently several problems concerning Chapter 110C:

1. The "penalty box" provision was held unconstitutional by the 1st Circuit in the Hyde Park decision (1988) based on the Supremacy and Commerce Clause arguments developed in Edgar v. MITE Corp., 457 U.S. 624 (1982).

2. The Secretary of State's Office faces substantial problems in obtaining/enforcing subpoenas to obtain information from out-of-state purchasers.

3. The expense and difficulty associated with collecting relevant information, analyzing it and conducting hearings is high given 110C's uncertain constitutional status, leading the Secretary of State to implement the statute only at the request of a target company.

M.G.L. c. 110D

Chapter 110D is the Control Share Acquisition Law enacted in July 1987 as it applies to domestic corporations. The principle issues relating to 110D concern its effectiveness rather than its constitutionality. The general sense appears to be that it may be effective in extending the amount of time a target might have to evaluate and respond to an unsolicited offer and, perhaps, at the margin increase the offer price. The principle concern raised has been the use of 110D by an under-financed bidder to put a company in play to use the special shareholder meeting requirement as a mechanism to get control. The result has been that many/most Massachusetts firms have opted out of 110D coverage understanding that they may opt back in at any time.

M.G.L. c. 110E

Chapter 110E is the Control Share Acquisition Law enacted in July 1987 as it applies to foreign corporations. There are basically two problems:

1. A virtually identical Oklahoma statute was held to be an unconstitutional burden on interstate commerce in TLX Acquisition Corp. v. Telex Corp., (W.D. Okla. Nov. 3, 1987) [For an opposing viewpoint see attached brief written by Martin Lipton.]

2. The new SEC Rule concerning voting rights, 19c-4, would result in the delisting of the common stock of a corporation that invoked 110E as a protection.

I would like to thank Barry Guthary and Carl Valvo for their assistance.

RECOMMENDATION A:

Several options for possible action have been suggested:

1. Amend 110C to limit its application to domestic corporations or to establish a stronger nexus as was done in 110E (see below) to avoid challenge on Commerce Clause grounds.

2. Re-write the disclosure provisions to require that additional information required by the Secretary of State's Office go to investors to undercut arguments that 110C's primary purpose is to delay rather than protect investors.

3. Amend the "penalty box" provision to substitute substantial monetary fines for the current prohibition on further purchases.

4. Modify the enforcement provisions to give the Securities Division of the Secretary of State's Office the power to levy fines for non-compliance with hearing procedures, including the failure to obey a subpoena issued in a proceeding. This might effectively address the out-of-state subpoena problem, at least as it relates to the production of documents. Personal appearances of parties would still present a problem given the short time frame required by the Act.

5. Time frames could be modified to match those of the Williams Act.

PROS:

Each of the above amendments would either mitigate or cure constitutional or implementation problems that have been presented to the Commission.

Strengthening/curing Chapter 110C would increase the effectiveness of the earliest early notice provision (5% interest) we have and the only statute that has ever been used to successfully enjoin a takeover nationwide, Kenner Parker.

CONS:

The utility of the above proposals is predicated on the assumption that Judge Coffin's Supremacy Clause analysis in the Hyde Park case can be reversed based on the differing rationales used in Edgar v. MITE (1982) and CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987).

RECOMMENDATION B:

Expand application of Chapters 110C, 110D and/or 110E to include banks, insurance companies and/or other business entities facing potentially coercive takeovers but organized under Chapters other than 156B corporations.

PROS:

Provides uniform application provisions enacted to address of public policy concerns relating coercive takeovers of 156B corporations to comparable business entities chartered under other chapters of the general laws.

CONS:

By introducing language that differs from the that contained in the Indiana Control Share Acquisition Law, increases the risk that it could be held unconstitutional.

<u>RECOMMENDATION C</u>:

Monitor legal developments relating to the constitutionality and utility of Chapter 110E, such as appeals of the Telex decision and the future application of SEC Rule 19c-4.

<u>RECOMMENDATION D</u>:

Repeal M.G.L. c. 110E.

PROS:

Increases the Commonwealth's credibility in arguing that it is carefully considering the constitutional issues raised by anti-takeover laws in its attempt to craft a balanced response that takes the various interests of corporations, shareholders, stakeholders, and acquirers into consideration.

Reduces grounds for litigation in Massachusetts takeover cases, saving court time, legal fees and the resources of the Attorney General's Office.

CONS:

Requires decision that in light of the Telex decision and the SEC voting rights Rule 19c-4, Chapter 110E is almost certainly either unconstitutional or unhelpful.

CHAPTER 110C.

REGULATION OF TAKE-OVER BIDS IN THE ACQUISITION OF CORPORATIONS.

110C:1. Definitions.

Section 1. As used in this chapter the following words shall, unless the context otherwise requires, have the following meanings:—

"Affiliate of an offeror", any person controlling, controlled by, or under common control with an offeror.

"Associate of an offeror", (1) Any corporation or other organization of which the offeror is an officer or partner or is, directly or indirectly, the beneficial owner of ten per cent or more of any class of equity securities; (2) Any person who is, directly or indirectly, the beneficial owner of ten per cent or more of any class of equity securities of the offeror; (3) Any trust or other estate in which the offeror has a substantial beneficial interest or as to which the offeror serves as a trustee or in a similar fiduciary capacity; and (4) Any relative or spouse of the offeror or any relative of such spouse who has the same home as the offeror.

"Equity security", any shares or similar securities, or any securities convertible into such securities, or carrying any warrant or right to subscribe to or purchase such securities, or any such warrant or right, or any other security which, for the protection of security holders, is treated as an equity security pursuant to chapter one hundred and ten A.

"Offeree", the beneficial or record owner of securities which an offeror acquires or offers to acquire in connection with a take-over bid.

"Offeror", a person who makes, or in any way participates or aids in making, a take-over bid, and includes persons acting jointly or in concert, or who intend to exercise jointly or in concert any voting rights attached to the securities for which such take-over bid is made. "Offeror" does not include any bank or broker-dealer lending funds to an offeror in the ordinary course of its business, or any bank, broker-dealer, attorney, accountant, consultant, employee, or other person furnishing information or advice to, or performing ministerial duties for, an offeror, and not otherwise participating in the take-over bid.

"Person", an individual, a corporation, a partnership, an association, a joint-stock company, a trust where the interests of the beneficiaries are evidenced by a security, or an unincorporated organization.

"Principal place of business" of a corporation, the corporate headquarters where the general executive offices are located and from which the corporation's activities are controlled and directed by executive officers of the corporation.

"Secretary", the state secretary.

"Take-over bid", the acquisition of or offer to acquire, whether by a formal public announcement, by a tender offer or request or invitation for tenders, by the accumulation of stock in the market or the solicitation of particular shareholders, or otherwise any equity security of a target company if, after acquisition thereof, the offeror and the associates and affiliates of the offeror would be directly or indirectly the beneficial owners of more than ten per cent of any class of the issued and outstanding equity securities of such target company. In determining whether a person is directly or indirectly a beneficial owner of equity securities of any class, such person shall be deemed to be the beneficial owner of equity securities of such class which such person has the right to acquire through the exercise of presently exercisable options, warrants, or rights or through the conversion of presently convertible securities or otherwise. The equity securities subject to such options, warrants, rights, or conversion privileges held by a person shall be deemed to be outstanding for the purpose of computing the percentage of outstanding equity securities of the class owned by such person but shall not be deemed to be outstanding for the purpose of computing the percentage of the class owned by any other person. A take-over bid does not include:- (1) A bid made by a dealer for his own account in the ordinary course of his business of buying and selling such security in which the dealer does not solicit or arrange for the solicitation of offers to sell shares; (2) An offer to acquire such equity security for consideration consisting primarily of securities covered by a current prospectus forming a part of a registration statement which has become effective under 15 USC s 77a et seq.: (3) An offer made by an offeror to acquire its own securities or securities of a subsidiary, at least two-thirds of the voting securities of which subsidiary are owned beneficially by the offeror; (4) Any take-over bid to which the target company consents, by action of its board of directors, if such board of directors has recommended acceptance thereof to shareholders and the terms thereof, including any inducements to officers or directors which are not made available to all shareholders, have been furnished to shareholders; (5) An offer which, if accepted by all offerees, shall not result in the offeror having acquired more than two per cent of the same class of equity securities of the issuer within the preceding twelve-month period; or (6) An offer to acquire equity securities of any corporation if the total number of the beneficial owners of all of the classes of the equity securities of such corporation shall be less than twenty-five persons.

"Target company", a corporation, organized under the laws of or having its principal place of business in the commonwealth, whose securities are or are to be the subject of a take-over bid.

110C:2. Announcement; Filing; Hearing.

Section 2. No offeror shall make a take-over bid unless he announces publicly the terms of the proposed take-over bid, files with the secretary and the target company, on the date of the commencement of the take-over bid, copies of all information required by section four, and pays the secretary a filing fee of one thousand dollars to defray the costs of any investigation the secretary may make in connection therewith.

Within five days following such filing, or after a request made by the target company or an offeree within said five days, the secretary may order a hearing within ten days following such filing if he determines it necessary or appropriate for the protection of offerees in the commonwealth. If no such hearing is ordered within said ten days or a hearing is so ordered within such time and after hearing the secretary adjudicates that the take-over bid is not in violation of this chapter and that effective provision is made for fair and full disclosure to offerees of all information material to a decision to accept or reject the offer, the take-over bid shall be deemed to be in compliance with this chapter. If the secretary finds that the take-over bid would comply with provisions of this chapter if amended in certain respects, the take-over bid shall be deemed to be in compliance with this chapter only if so amended.

110C:3. Holding of Securities in Target Company.

Section 3. No offeror shall make a take-over bid if he and his associates and affiliates are directly or indirectly the beneficial owners of five per cent or more of the issued and outstanding equity securities of any class of the target company, any of which were purchased within one year before the proposed take-over bid, and the offeror, before making any such purchase, or before the thirtieth day following the effective date of this section, whichever is later, failed to publicly announce his intention to gain control of the target company, or otherwise failed to make fair, full, and effective disclosure of such intention to the persons from whom he acquired such securities.

110C:4. Information Required in Filing.

Section 4. The information to be filed by the offeror with the secretary and the target company pursuant to section two shall include:—

Copies of all prospectuses, brochures, advertisements, circulars, letters, or other matter by means of which the offeror proposes to disclose to offerees all information material to a decision to accept or reject the offer;

The identity and background of all persons on whose behalf the acquisition of any equity security of the target company has been or is to be effected;

The source and amount of funds or other consideration used or to be used in acquiring any equity security, including a statement describing

any securities, other than the existing capital stock or long term debt of the offeror, which are being offered in exchange for the equity securities of the target company, and if any part of the acquisition price is or will be represented by borrowed funds or other consideration, a description of the material terms of any financing arrangements and the names of the parties from whom the funds were borrowed;

A statement of any plans or proposals which the offeror, upon gaining control, may have to liquidate the target company, sell its assets, effect a merger or consolidation of it, or make any other major change in its business, corporate structure, management personnel, or policies of employment;

The number of shares of any equity security of the target company of which each offeror or an affiliate or an associate of each offeror is beneficial or record owner or has a right to acquire, directly or indirectly, together with the name and address of each person defined in this section as an offeror;

Particulars as to any contracts, arrangements, or understandings to which an offeror is party with respect to any equity security of the target company, including without limitation transfers of any equity security, joint ventures, loan or option arrangements, puts and calls, guarantees of loan, guarantees against loss, guarantees of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into;

Complete information on the organization and operations of offeror, including without limitation the year of organization, form of organization, jurisdiction in which it is organized, a description of each class of the offeror's capital stock and of its long term debt, audited balance sheets and income statements for each of the three most recent fiscal years and if the most recent balance sheet and income statement are for a period ended more than ninety days prior to the date of filing, an interim balance sheet and income statement covering the period from the date of the last audited balance sheet and income statement filed hereunder to a date within ninety days of the date of filing, a brief description of the location and general character of the principal physical properties of the offeror and its subsidiaries, a description of pending legal proceedings other than routine litigation to which the offeror or any of its subsidiaries is a party or of which any of their property is the subject, a brief description of the business done and projected by the offeror and its subsidiaries and the general development of such business over the past five years, the names of all directors and executive officers together with biographical summaries of each for the preceding five years to date, and the approximate amount of any material interest, direct or indirect, of any of the directors or officers in any material transaction during the past three years, or in any proposed material transactions to which the offeror or any of its subsidiaries was or is to be a party;

A description of any court or governmental proceeding in which the offer has been disapproved or enjoined and of any pending court or governmental proceeding in which it is alleged that the offer does not comply with the provisions of the applicable laws or regulations;

A statement of which other tender offers subject to Section 13 Clause (d) or proxy contests subject to section 14 of The Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq*, as amended, the offeror has engaged in within five years prior to the offer;

A statement of whether any officer or director of the offeror or the offeror has

(1) been convicted within the prior ten years of a felony, or

(2) been subject of a judgment or decree entered by a court or governmental agency with respect to laws relating to

(a) anti-trust,

(b) fair employment practices,

(c) purchase or sale of securities, or

(d) environmental protection; and

Such other and further documents, exhibits, data, and information as may be required by regulations of the secretary or as may be necessary to make fair, full, and effective disclosure to offerees of all information material to a decision to accept or reject the offer.

In connection with any take-over bid which is subject to federal law, the secretary may permit any offeror to file any document, schedule or statement required to be filed with the appropriate federal agency in lieu of the information required by this section, with such additions or modifications as the secretary may prescribe.

110C:5. Promotional Materials.

Section 5. Copies of all advertisements, circulars, letters or other solicitation materials published by the offeror or the target company on or after the date that the take-over bid may be made in accordance with section two shall be filed with the secretary and delivered by the target company, or the offeror, as the case may be, to the other of them on the date that the same are first published or used or sent to offerees.

110C:6. Procedure for Hearing.

Section 6. Any hearing pursuant to this section shall be commenced within twenty days of the date a filing is made pursuant to section two. Adjudications made pursuant to this section shall be made within forty-five days after such filing and pursuant to section four hundred and twelve of chapter one hundred and ten A. Upon filing an application with the secretary for a hearing under this section, the target company shall pay to the secretary a fee of two hundred fifty dollars, and shall deposit with the secretary such sum, not exceeding seven hundred fifty dollars, as the secretary may require to defray the costs of such hearing and

any investigation which the secretary may make in connection therewith. If, after hearing, the secretary finds that the take-over bid is in violation of this chapter or that effective provision is not made for fair and full disclosure to offerees of all information material to a decision to accept or reject the offer, he shall so adjudicate. If he finds that the take-over bid would comply with this chapter if amended in certain respects, he shall so adjudicate. If he finds that the take-over bid is not in violation of this chapter and that effective provision is made for fair and full disclosure to offerees of all information material to a decision to accept or reject the offer, he shall so adjudicate.

110C:7. Prohibited Conduct; Withdrawal of Securities.

Section 7. It is unlawful for any offeror or target company or any affiliate or associate of an offeror or target company or any broker-dealer acting in behalf of an offeror or target company to make any untrue statement of a material fact or to conceal any material fact in order to make the statements misleading, or to engage in any fraudulent, evasive, deceptive, manipulative or grossly unfair practices in connection with a take-over bid.

No take-over bid shall be made unless it is made under the provisions of this chapter, and no offeror shall make a take-over bid which is not made to all holders residing in the commonwealth of the equity security that is the subject of such take-over bid, or which is not made to such holders on the same terms as such take-over bid is made to holders of such equity security not residing within the commonwealth. If a take-over bid is made for less than all the outstanding equity securities of any class and if the number of securities deposited pursuant thereto is greater than the number the offeror has agreed to accept, the offeror shall take up and pay for the securities pro-rata, disregarding fractions, according to the number of securities deposited by each offeree. If the terms of a take-over bid are changed before its expiration by increasing the consideration offered to offerees, the offeror shall pay the increased consideration for all equity securities taken up, whether the same are deposited or taken up before or after the change in the terms of the take-over bid.

No offeror shall make a take-over bid which does not remain open for at least fifteen days after it is deemed to be in compliance with this chapter with the right to extend such period; purchase any shares pursuant to a take-over bid prior to the expiration of such fifteen day period; offer to pay an offeree a fee, commission or any other consideration not offered to all offerees; or publish or use in connection with the offer any false statement of a material fact or conceal a material fact in order to make the statement misleading.

Securities deposited pursuant to a take-over bid may be withdrawn by an offeree or his attorney-in-fact by demand in writing to the offeror

or the depository at any time up to five days prior to the announced termination date of the offer.

110C:8. Copy of Filing Furnished to Regulatory Boards.

Section 8. If the offeror or the target company is a banking corporation subject to regulation by the commissioner of banks, or a public utility corporation subject to regulation by the department of public utilities, the secretary shall forthwith, upon receipt of the filing required under section two, furnish a copy of such filing to the regulatory body having jurisdiction over the offeror or target company.

110C:9. Remedies for Violations; Persons Liable.

Section 9. (a) Any offeror who purchases a security in connection with a take-over offer in violation of this chapter shall be liable to the person selling the security to him who may sue either at law or in equity. In an action for rescission the seller shall be entitled to recover the security, plus any income received by the purchaser thereon, upon tender of the consideration received. Tender requires only notice of willingness to pay the amount specified in exchange for the security. Any notice may be given by service as in civil actions or by certified mail to the last known address of the person liable. Damages are the excess of either the value of the security on the date of purchase or its present value, whichever is greater, over the present value of the consideration received for the security.

(b) Every associate and affiliate of a person liable under paragraph (a), every partner, principal executive officer or director of such person, every person occupying a similar status or performing similar functions, every employee of such person who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, is also liable jointly or severally with and to the same extent as such person, unless the person who would otherwise be so liable proves that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(c) No action may be maintained under paragraph (a) or (b) unless commenced before the expiration of three years after the act or transaction constituting the violation or the expiration of one year after the discovery of the facts constituting the violation, whichever first expires.

(d) The rights and remedies under this chapter are in addition to any other rights or remedies that may exist at law or in equity.

(e) Whenever it appears to the secretary that any person has engaged or is about to engage in any act or practice constituting a violation of this chapter, or any rule or order hereunder, (1) he may issue and cause

to be served upon any person violating any of the provisions of this chapter, an order requiring the person guilty thereof to cease and desist therefrom; and (2) he may bring an action in the superior court division of the appropriate county to enjoin the acts or practices and to enforce compliance with this chapter, or any rule or order hereunder, or he may refer the matter to the attorney general or the district attorney of the appropriate county.

(f) Any person, who violates section two or any rule thereunder, or any order of which he has notice, or who willfully violates section seven or any rule or order thereunder, may be fined not more than five thousand dollars or imprisoned for not more than three years or both. Each of the acts specified shall constitute a separate offense and a prosecution or conviction for any one of such offenses shall not bar prosecution or conviction for any other offense. No indictment or information may be returned under sections two and seven more than six years after the alleged violation.

(g) The secretary may refer such evidence as is available concerning violations of this chapter or of any rule or order hereunder to the attorney general or the district attorney of the appropriate county who may, with or without any reference, institute the appropriate criminal proceedings under this chapter. If referred to a district attorney, he shall within ninety days file with the secretary a statement concerning any action taken or, if no action has been taken, the reasons therefor.

(h) Nothing in this chapter limits the power of the state to punish any person for any conduct which constitutes a crime under any other statute.

(i) Whenever any person has engaged or is about to engage in any act or practice constituting a violation of this chapter or any rule or order hereunder, the offeror, target company or any offeree may bring an action in the superior court division of the appropriate county to enjoin that person from continuing or doing any act in violation of this chapter.

(j) Upon an appropriate showing in any action brought under paragraph (e) or (i), the court may grant a permanent or temporary injunction or restraining order and may order a rescission of any sales or purchases of securities determined to be unlawful under this chapter, or any rule or order hereunder.

110C:10. Rules and Regulations.

Section 10. (a) The secretary may, pursuant to section four hundred and twelve of chapter one hundred and ten A prescribe reasonable rules and regulations or issue orders with respect to particular situations:

(1) Defining any terms used in this chapter including fraudulent, evasive, deceptive, manipulative or grossly unfair practices in connection with take-over bids.

(2) Exempting from this chapter take-over bids not made for the purpose of, and not having the effect of, changing or influencing the control of a target company.

(3) Covering such other matters as are necessary to give effect to this chapter.

(4) Waiving jurisdiction over a take-over bid if he determines that: (i) the take-over bid is subject to the jurisdiction of another state having a statute or regulation similar in purpose and effect to this chapter; (ii) information similar to that specified in section four is required to be filed with the administrator of such other state; (iii) such other state has a greater interest in regulating the take-over bid than the commonwealth, and (iv) the purpose of this chapter will be accomplished and the public interest will be better served by such waiver.

(b) The secretary may delegate to the director of securities the authority to perform any duty and exercise any power assigned to the secretary under the provisions of this chapter.

110C:11. Substitution of Insurance Commissioner.

Section 11. If the offeror or a target company is an insurance company subject to regulation under chapter one hundred and seventy-five to chapter one hundred and seventy-five C, inclusive, the commissioner of insurance shall for all purposes of this section be substituted for the secretary. This section shall not be construed to limit or modify in any way any responsibility, authority, power, or jurisdiction of the secretary or the commissioner of insurance pursuant to any other provisions of law.

110C:12. Applicability of Chapter.

Section 12. This chapter does not apply when:—

(a) The offeror or the target company is a public utility or a public utility holding company as defined in section two of the "Public Utility Holding Company Act of 1935", 15 U.S.C. 79, as amended, and the take-over bid is subject to approval by the appropriate federal agency as provided in such act;

(b) The offeror or the target company is a bank or a bank holding company subject to the "Bank Holding Company Act of 1956", 12 U.S.C. 1841, as amended, and the take-over bid is subject to approval by the appropriate federal agency as provided in such act;

(c) The offeror or the target company is a savings and loan holding company as defined in section two of the "Savings and Loan Holding Company Amendments of 1967", 12 U.S.C. 1730A, as amended, and the take-over bid is subject to approval by the appropriate federal agency as provided in such act;

(d) The offeror and the target company are banks and the offer is part of a merger transaction subject to approval by appropriate federal supervisory authorities.

110C:13. Severability.

Section 13. The provisions of this chapter are severable and if any such provision or the application of such provision to any person or circumstances shall be held to be invalid or unconstitutional, such invalidity or unconstitutionality shall not affect the validity or constitutionality of any of the remaining provisions of this chapter or the application of such provision to said person or circumstances.

Chapter 272.

THE COMMONWEALTH OF MASSACHUSETTS

In the Year One Thousand Nine Hundred and Eighty-seven

AN ACT REGULATING CONTROL SHARE ACQUISITIONS.

Whereas, The deferred operation of this act would tend to defeat its purpose, which is to immediately regulate control share acquisitions, therefore it is hereby declared to be an emergency law, necessary for the immediate preservation of the public convenience.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. The General Laws are hereby amended by inserting after chapter 110C the following chapter:-

CHAPTER 110D.

REGULATION OF CONTROL SHARE ACQUISITIONS.

Section 1. As used in this chapter, the following words, unless the context clearly requires otherwise, shall have the following meanings:-

(a) "Associate", any person who directly or indirectly controls, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquisition; as used herein, control shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten per cent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person serves as trustee or in a similar fiduciary capacity; and any relative or spouse of a person, or any relative of such spouse, any one of whom has the same residence as such person.

(b) "Beneficial ownership", the sole or shared power to dispose or direct the disposition of shares or the sole or shared power to vote or to direct the

voting of shares, whether such power is direct or indirect or through any contract, arrangement, understanding, relationship or otherwise. A person shall not be deemed to be a beneficial owner of shares as to which such person may exercise voting power solely by virtue of a revocable proxy conferring the right to vote. A member of a national securities exchange shall not be deemed to be a beneficial owner of shares held directly or indirectly by it on behalf of another person solely because such member is the record holder of such securities and, pursuant to the rules of such exchange, may direct the vote of such shares, without instruction, on other than contested matters or matters that may affect substantially the rights or privileges of the holders of the shares to be voted but is otherwise precluded by the rules of such exchange from voting without instructions.

(c) (1) "Control share acquisition", the acquisition by any person of beneficial ownership of shares of an issuing public corporation which, but for the provisions of this chapter, would have voting rights and which, when added to all other shares of such corporation beneficially owned by such person, would entitle such person, upon acquisition of such shares, to vote or direct the voting of shares of such corporation having voting power in the election of directors within any of the following ranges of such voting power:-

(i) one-fifth or more but less than one-third of all voting power;

(ii) one-third or more but less than a majority of all voting power; or

(iii) a majority or more of all voting power.

If this chapter applies to an issuing public corporation at the time a person makes a control share acquisition, all shares of such issuing public corporation the beneficial ownership of which is acquired by such person within ninety days before or after the date on which such person makes an acquisition of beneficial ownership of shares which results in such control share acquisition, regardless of whether this chapter was in effect or applies to such corporation during such ninety day period, and all shares acquired by such person pursuant to a plan to make a control share acquisition, shall be deemed to have been acquired in the same control share acquisition for purposes of this chapter.

(2) Subject to the provisions of the last paragraph of paragraph (1) of subsection (c), a "control share acquisition" shall not include the acquisition of beneficial ownership of shares acquired:

(i) before June twenty-sixth, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares acquired before such date exceeds the range of voting power established by clause (i) of paragraph (1);

(ii) pursuant to a contract to acquire shares existing before June twenty-sixth, nineteen hundred and eighty-seven;

(iii) during any period after July fifteenth, nineteen hundred and eighty-seven that this chapter does not apply to the issuing public corporation pursuant to the provisions of section two;

(iv) by will or pursuant to the laws of descent and distribution;

(v) pursuant to the satisfaction of a pledge or other security interest created in good faith and not for the purpose of circumventing the provisions of this chapter;

(vi) pursuant to a tender offer, merger or consolidation, but only if such tender offer, merger or consolidation is pursuant to an agreement of merger or consolidation to which the issuing public corporation is a party; or

(vii) directly from the issuing public corporation or a wholly-owned subsidiary thereof.

(3) The acquisition of beneficial ownership of shares of an issuing public corporation does not constitute a control share acquisition if the acquisition is made by or from:

(i) a person whose voting rights with respect to shares of such corporation were previously authorized by the stockholders of the corporation in compliance with this chapter, unless such acquisition, when added to all other shares of such corporation beneficially owned by the person making such acquisition, would entitle such acquiring person to vote or direct the voting of shares of such corporation having voting power in the election of directors in excess of the range of voting power within which all shares beneficially owned by such person whose voting rights were previously so authorized had voting power immediately following such authorization; or

(ii) a person whose previous acquisition of beneficial ownership of shares of such corporation would have constituted a control share acquisition but for the provisions of paragraph (2) of subsection (c), unless such later acquisition, when added to all other shares of such corporation beneficially owned by the person making such acquisition, would entitle such acquiring person to vote or direct the voting of shares of such corporation having voting power in the election of directors in excess of the range of voting power within which

the person who made such previous acquisition could exercise voting power immediately following such previous acquisition.

(d) "Interested shares", the shares of an issuing public corporation which are beneficially owned by:

(i) any person who has acquired or proposes to acquire beneficial ownership of shares of such issuing public corporation in a control share acquisition;

(ii) any officer of the issuing public corporation; or

(iii) any employee of the issuing public corporation who is also a director of such corporation.

(e) "Issuing public corporation", a corporation to which the provisions of section three of chapter one hundred and fifty-six B applies or to which the provisions of section three of chapter one hundred and sixty-four applies, or a trust or association subject to regulations under sections three to fourteen, inclusive, of chapter one hundred and eighty-two; provided, however, that such issuing public corporation has:

(i) two hundred or more stockholders of record; and

(ii) its principal place of business, its principal office, or substantial assets within the commonwealth; and

(iii) either: more than ten per cent of its stockholders of record residing within the commonwealth; or more than ten per cent of its issued and outstanding shares owned of record by residents of the commonwealth.

The record date for determining the percentages and numbers of stockholders and shares specified in this subsection shall be the last stockholder record date before the control share acquisition as to which the determination is being made or, if earlier, before the date on which a control share acquisition statement relating thereto is filed under the provisions of section three. A stockholder record date is the date fixed by the board of directors, or if applicable, the date when transfer books are closed by the board of directors, in connection with determining stockholders entitled to notice of and vote at a meeting, or to consent or dissent, to receive any dividend or other distribution, or for the purpose of any other lawful action. If a stockholder record date has not been fixed by the board of directors within the preceding four months, the determination shall be made as of the end of the issuing public corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the address appearing in the records of the corporation. Shares held of record by brokers or nominees shall be disregarded for purposes of calculating the percentages and numbers specified in this subsection. Any shares of an issuing public corporation allocated to the account of an employee or former employee, or beneficiaries of employees or former employee, of such corporation and held in a plan that is qualified under section 401(a) of the Internal Revenue Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee to whose account such shares are allocated.

(f) "Person", any individual, corporation, partnership, unincorporated association or other entity, and any associate of any such person.

Section 2. (a) If the articles of organization or by-laws of an issuing public corporation provide, at the time of any control share acquisition which occurs prior to January first, nineteen hundred and eighty-eight, that this chapter shall apply to control share acquisitions of such corporation, shares of such corporation acquired in any such control share acquisition shall have only such voting rights as are authorized pursuant to the provisions of section five.

(b) If the board of directors of an issuing public corporation has adopted a vote prior to any control share acquisition which occurs prior to January first, nineteen hundred and eighty-eight, that the provisions of this chapter shall apply to control share acquisitions of such corporation, shares of such corporation acquired in any such control share acquisition shall have only such voting rights as are authorized pursuant to the provisions of section five. Within thirty days after the adoption of any such vote, the corporation shall submit to the state secretary a certificate signed under the penalties of perjury by the president or a vice president and by the clerk or an assistant clerk setting forth a copy of such vote of the directors, the date of adoption of such vote, and a certification that such vote was duly adopted by the directors.

(c) Unless the articles of organization or by-laws of an issuing public corporation provide, at the time of any control share acquisition which occurs on or after January first, nineteen hundred and eighty-eight, that the provisions of this chapter shall not apply to control share acquisitions of such

corporation, shares of such corporation acquired in such control share acquisition shall have only such voting rights as are authorized pursuant to section five.

(d) If the articles of organization or by-laws of an issuing public corporation are amended to provide that the provisions of this chapter shall not apply to control share acquisitions of such corporation, or to eliminate a provision that this chapter shall not apply to control share acquisitions of such corporation, any such amendment shall apply only to control share acquisitions which occur after the effective date of such amendment.

(e) No amendment to the articles of organization adopted by a corporation pursuant to the provisions of this section shall be considered to affect the rights of stockholders adversely within the meaning of the provisions of section seventy-seven of chapter one hundred and fifty-six B.

Section 3. Any person who has made a control share acquisition or has made a bona fide written offer to make a control share acquisition may deliver to the issuing public corporation, personally or by registered or certified mail at its principal office, a control share acquisition statement which shall contain the following:

(i) the identity of such person and any associate of such person who intends to acquire or has acquired beneficial ownership of shares of the issuing public corporation;

(ii) a statement that such control share acquisition statement is being made and delivered pursuant to the provisions of this chapter;

(iii) the number and class or series of shares of the issuing public corporation beneficially owned by such person and each associate of such person prior to the control share acquisition;

(iv) the number and class or series of shares acquired or proposed to be acquired by such person pursuant to the control share acquisition and the range of voting power to which the control share acquisition is or, if consummated, would be subject pursuant to the provisions of subsection (c) of section one;

(v) a description of the terms and conditions of the proposed or completed control share acquisition, including but not limited to the prices paid by such person in the control share acquisition and the dates upon which the shares were acquired; and

(vi) if the control share acquisition has not been completed, a representation by such person that such person has the financial capacity to consummate the proposed control share acquisition, together with a statement in reasonable detail of the material facts upon which such representation is based.

Section 4. (a) If the person delivering the control share acquisition statement so demands in writing contemporaneously with the delivery of such control share acquisition statement, the board of directors of the issuing public corporation, within ten days after the receipt of the demand, shall call a special meeting of stockholders for the purpose of considering whether voting rights shall be authorized for the shares acquired or to be acquired in the control share acquisition. The demand shall not be effective unless accompanied by an undertaking to pay the corporation's reasonable expenses in connection with the special meeting but not including the expenses of the corporation incurred in opposing a vote to authorize voting rights for the shares acquired or proposed to be acquired in the control share acquisition. As promptly as reasonably practicable after the board has called the special meeting, the corporation shall give written notice of the special meeting to stockholders. Such notice shall be given not less than twenty days before the date of the special meeting. Unless the person delivering the control share acquisition statement and the corporation shall agree in writing to a later date, the special meeting shall be held not more than fifty days after the receipt by the corporation of the demand. If the person delivering the control share acquisition statement so requests in the demand, the special meeting shall be held no sooner than thirty days after receipt by the corporation of the demand.

(b) If no demand respecting a special meeting of the issuing public corporation's stockholders is made in accordance with subsection (a), consideration of the voting rights to be authorized for the shares acquired or to be acquired in the control share acquisition shall be presented at the next annual or special meeting of the corporation's stockholders notice of which has not been given prior to the receipt by the corporation of the control share acquisition statement.

(c) The notice to the issuing public corporation's stockholders of any annual or special meeting at which the voting rights to be accorded shares acquired or proposed to be acquired in a control share acquisition are to be considered shall be directed to all stockholders of record of the issuing pub-

lic corporation as of the record date set for such meeting. Such notice shall include or be accompanied by a copy of the control share acquisition statement received by the issuing public corporation pursuant to this chapter, notice of rights, if any, arising pursuant to section seven and such other information as the issuing public corporation deems appropriate.

Section 5. Shares acquired in a control share acquisition shall have the same voting rights as all other shares of the same class or series of the issuing public corporation only to the extent authorized by vote of the stockholders of the issuing public corporation at any annual meeting of stockholders or special meeting of stockholders. Such authorization shall require the affirmative vote of the holders of a majority of all of the shares entitled to vote generally in the election of directors, excluding interested shares. Interested shares shall be disregarded for determining a quorum and shall not be entitled to vote with respect to such authorization. If no such vote is adopted, such shares shall regain their voting rights upon transfer of beneficial ownership of such shares to another person unless such transfer constitutes a control share acquisition by the acquirer, in which event the voting rights of such shares shall be subject to the provisions of this chapter.

Section 6. (a) The articles of organization or by-laws of an issuing public corporation, by provision effective at the time of the occurrence of a control share acquisition, may authorize the redemption, at the option of such corporation but without requiring the agreement of the person who has made a control share acquisition, of all but not less than all shares acquired in such a control share acquisition, from such person for the fair value of such shares if:

(i) no control acquisition statement has been delivered; or

(ii) a control acquisition statement has been delivered and voting rights were not authorized for such shares by the stockholders in accordance with the provisions of section five.

(b) Notice of such redemption shall be given by the issuing public corporation not later than sixty days after the date on which the stockholders of the issuing public corporation voted not to authorize voting rights for the shares to be redeemed, or if no control share acquisition statement has been delivered prior to the date on which notice of redemption is given by the issuing public corporation, sixty days after the first date on which the board of directors of the issuing public corporation has actual knowledge of such control share acquisition.

(c) For purposes of this section, fair value shall be determined as of the date on which stockholders of the issuing public corporation voted not to authorize voting rights for the shares to be redeemed, or, if no control acquisition statement is delivered, as of the date on which the issuing public corporation determines to make a redemption under this section. Such value shall be determined in accordance with procedures adopted by the issuing public corporation and without regard to the effect of the denial of voting rights under the provisions of section five.

Section 7. Unless otherwise expressly provided in an issuing public corporation's articles of organization or by-laws in effect at the time of a control share acquisition of shares of such corporation, if voting rights are authorized for shares acquired in such control share acquisition in accordance with the provisions of section five and, in such control share acquisition, the person making such control share acquisition has acquired beneficial ownership of shares that, when added to all other shares of such corporation beneficially owned by such person, entitle such person to vote, or direct the voting of, shares of such corporation having a majority or more of all voting power in the election of directors, each stockholder of record of such corporation, other than the person making such control share acquisition, who has not voted in favor of authorizing voting rights for the shares acquired in such control share acquisition may demand payment for his stock and an appraisal in accordance with the provisions of section eighty-six to ninety-eight, inclusive, of chapter one hundred and fifty-six B, and such stockholder and such corporation shall have the rights and duties and follow the procedures set forth in those sections as nearly as practicable. For purposes of said sections eighty-six to ninety-eight, inclusive, the corporate action shall be deemed to have become effective on the later of the date such voting rights are authorized or the date on which such control share acquisition is made. For purposes of this section, fair value shall be determined as of the date on which the stockholders authorize voting rights for the shares acquired in such control share acquisition, but in no event it shall be less than the highest price per share paid by the person who made such control share acquisition in such control share acquisition.

Section 8. To the extent that any provision of this chapter is inconsistent with any provision of chapter one hundred and fifty-six B, one hundred sixty-four or one hundred and eighty-two the provisions of this chapter shall govern.

No provisions of this chapter shall be deemed to limit the power of an association or trust to amend its instrument or declaration of trust to the extent otherwise lawful.

SECTION 2. The General Laws are hereby further amended by inserting after chapter 110D the following chapter:

CHAPTER 110E.

REGULATION OF CONTROL SHARE ACQUISITIONS OF FOREIGN CORPORATIONS.

Section 1. As used in this chapter, the following words, unless the context clearly requires otherwise, shall have the following meanings:-

(a) "Associate", any person who directly or indirectly controls, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquisition; as used herein, "control" means the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten per cent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person serves as trustee or in a similar fiduciary capacity; and any relative or spouse of a person, any relative of such spouse, any one of whom has the same residence as such person.

(b) "Beneficial ownership", the sole or shared power to dispose or direct the disposition of shares or the sole or shared power to vote or to direct the voting of shares, whether such power is direct or indirect or through any contract, arrangement, understanding, relationship or otherwise. A person shall not be deemed to be a beneficial owner of shares as to which such person may exercise voting power solely by virtue of a revocable proxy conferring the right to vote. A member of a national securities exchange shall not be deemed to be a beneficial owner of shares held directly or indirectly by it on behalf of another person solely because such member is the record holder of such securities and, pursuant to the rules of such exchange, may direct the vote of such shares, without instruction, on other than contested matters or matters that may affect substantially the rights or privileges of the holders of the shares to be voted but is otherwise precluded by the rules of such exchange from voting without instruction.

(c) (1) "Control share acquisition", the acquisition by any person of beneficial ownership of shares of an issuing public corporation which, but for the provisions of this chapter, would have voting rights and which, when added to all other shares of such corporation beneficially owned by such person, would entitle such person, upon acquisition of such shares, to vote or direct the voting of shares of such corporation having voting power in the election of directors within any of the following ranges of such voting power:-

(i) one-fifth or more but less than one-third of all voting power;

(ii) one-third or more but less than a majority of all voting power; or

(iii) a majority or more of all voting power.

If this chapter applies to an issuing public corporation at the time a person makes a control share acquisition, all shares of such issuing public corporation the beneficial ownership of which is acquired by such person within ninety days before or after the date on which such person makes an acquisition of beneficial ownership of shares which results in such control share acquisition, regardless whether this chapter was in effect or applies to such corporation during such ninety day period, and all shares acquired by such person pursuant to a plan to make a control share acquisition, shall be deemed to have been acquired in the same control share acquisition for purposes of this chapter.

(2) Subject to the last paragraph of paragraph (1) of subsection (c), a "control share acquisition" does not include the acquisition of beneficial ownership of shares acquired:-

(i) before June twenty-sixth, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares acquired before such date exceeds the range of voting power established by clause (i) of paragraph (1);

(ii) pursuant to a contract existing before June twenty-sixth, nineteen hundred and eighty-seven;

(iii) during any period after July fifteenth, nineteen hundred and eighty-seven that this chapter does not apply to the issuing public corporation pursuant to the provisions of section two;

(iv) by will or pursuant to the laws of descent and distribution;

(v) pursuant to the satisfaction of a pledge or other security interest created in good faith and not for the purpose of circumventing this chapter;

(vi) pursuant to a tender offer, merger or consolidation, but only if such tender offer, merger or consolidation is pursuant to an agreement of merger or consolidation to which the issuing public corporation is a party; or

(vii) directly from the issuing public corporation or a wholly-owned subsidiary thereof.

(3) The acquisition of beneficial ownership of shares of an issuing public corporation does not constitute a control share acquisition if the acquisition is made by or from:-

(i) a person whose voting rights with respect to shares of such corporation were previously authorized by the stockholders of the corporation in compliance with this chapter, unless such acquisition, when added to all other shares of such corporation beneficially owned by the person making such acquisition, would enable such acquiring person to vote or direct the voting of shares of such corporation having voting power in the election of directors in excess of the range of voting power within which all shares beneficially owned by such person whose voting rights were previously so authorized had voting power immediately following such authorization; or

(ii) a person whose previous acquisition of beneficial ownership of shares of such corporation would have constituted a control share acquisition but for paragraph (2) of subsection (c), unless such later acquisition, when added to all other shares of such corporation beneficially owned by the person making such acquisition, would entitle such acquiring person to vote or direct the voting of shares of such corporation having voting power in the election of directors in excess of the range of voting power within which the person who made such previous acquisition could exercise voting power immediately following such previous acquisition.

(d) "Interested shares", the shares of an issuing public corporation which are beneficially owned by:-

(i) any person who has acquired or proposes to acquire beneficial ownership of shares of such issuing public corporation in a control share acquisition;

(ii) any officer of the issuing public corporation; or

(iii) any employee of the issuing public corporation who is also a director of such corporation.

(e) "Issuing public corporation", a corporation that has been established, organized or chartered under laws other than those of the commonwealth that has:-

(i) two hundred or more stockholders of record;

(ii) its principal executive office within the commonwealth and more of its employees, including employees of its majority owned subsidiaries, or assets employed or located in the commonwealth than in any other state as of the end of any of its four fiscal quarters immediately preceding the control share acquisition as to which the determination is being made or, if earlier, immediately preceding the date on which a control share acquisition statement relating thereto is delivered pursuant to section three and

(iii) either: more than ten per cent of its stockholders of record residing within the commonwealth; or more than ten per cent of its issued and outstanding shares owned of record by residents of the commonwealth.

The record date for determining the percentages and numbers of stockholders and shares specified in this subsection shall be the last stockholder record date before the control share acquisition as to which the determination is being made or, if earlier, before the date on which a control share acquisition statement relating thereto is filed under the provisions of section three. A stockholder record date is the date fixed by the board of directors, or if applicable, the date when transfer books are closed by the board of directors, in connection with determining stockholders entitled to notice of and vote at a meeting or to consent or dissent, to receive any dividend or other distribution, or for the purpose of any other lawful action. If a stockholder record date has not been fixed by the board of directors within the preceding four months, the determination shall be made as of the end of the public corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the address appearing in the records of the corporation. Shares held of record by brokers or nominees shall be disregarded for purposes of calculating the percentages and numbers specified in this subsection. Any shares of an issuing public corporation allocated to the account of an employee or former employee or beneficiaries of employees or former employees of such corporation and held in a plan that is qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee to whose account such shares are allocated.

(f) "Person", any individual, corporation, partnership, unincorporated association or other entity, and any associate of any such person.

Section 2. (a) If the charter or bylaws of an issuing public corporation provide, at the time of a control share acquisition, that this chapter applies to control share acquisitions of shares of such corporation, shares of such corporation acquired in such control share acquisition have only such voting rights as are authorized pursuant to the provisions of section five.

(b) A corporation may amend its charter or bylaws to eliminate a provision adopted pursuant to subsection (a), in which event this chapter shall not apply to any control share acquisition respecting the stock of such corporation which occurs after the effective date of such amendment.

Section 3. Any person who has made a control share acquisition or has made a bona fide written offer to make a control share acquisition may deliver to the issuing public corporation, personally or by registered or certified mail at its principal office, a control share acquisition statement which shall contain the following:-

(i) the identity of such person and any associate of such person who intends to acquire or has acquired beneficial ownership of shares of the issuing public corporation;

(ii) a statement that such control share acquisition statement is being made and delivered pursuant to this chapter;

(iii) the number and class or series of shares of the issuing public corporation beneficially owned by such person and each associate of such person prior to the control share acquisition;

(iv) the number and class or series of shares acquired or proposed to be acquired by such person pursuant to the control share acquisition and the range of voting power to which the control share acquisition is or, if consummated, would be subject pursuant to the provisions of subsection (c) of section one;

(v) a description of the terms and conditions of the proposed or completed control share acquisition, including but not limited to the prices paid by such person in the control share acquisition and the dates upon which the shares were acquired; and

(vi) if the control share acquisition has not been completed, a representation by such person that such person has the financial capacity to consummate the proposed control share acquisition, together with a statement in reasonable detail of the material facts upon which such representation is based.

Section 4. (a) If the person delivering the control share acquisition statement so demands in writing contemporaneously with the delivery of such control share acquisition statement, the board of directors of the issuing public corporation, within ten days after the receipt of the demand, shall call a special meeting of stockholders for the purpose of considering whether voting rights shall be authorized for the shares acquired or to be acquired in the control share acquisition. The demand will not be effective unless accompanied by an undertaking to pay the corporation's reasonable expenses in connection with the special meeting but not including the expenses of the corporation incurred in opposing a vote to authorize voting rights for the shares acquired or proposed to be acquired in the control share acquisition. As promptly as reasonably practicable after the board has called the special meeting, the corporation shall give written notice of the special meeting to stockholders. Such notice shall be given not less than twenty days before the date of the special meeting. Unless the person delivering the control share acquisition statement and the corporation shall agree in writing to a later date, the special meeting shall be held not more than fifty days after the receipt by the corporation of the demand. If the person delivering the control share acquisition statement so requests in the demand, the special meeting will be held no sooner than thirty days after receipt by the corporation of the demand.

(b) If no demand respecting a special meeting of the issuing public corporation's stockholders is made in accordance with the provisions of subsection (a), consideration of the voting rights to be authorized for the shares acquired or to be acquired in the control share acquisition shall be presented at the next annual or special meeting of the corporation's stockholders notice of which has not been given prior to the receipt by the corporation of the control share acquisition statement.

(c) The notice to the issuing public corporation's stockholders of any annual or special meeting at which the voting rights to be accorded shares acquired or proposed to be acquired in a control share acquisition are to be considered shall be directed to all stockholders of record of the issuing public corporation as of the record date set for such meeting. Such notice shall include or be accompanied by a copy of the control share acquisition statement received by the issuing public corporation pursuant to this chapter and such other information as the issuing public corporation deems appropriate.

Section 5. Shares acquired in a control share acquisition shall have the same voting rights as all other shares of the same class or series of the issuing public corporation only to the extent authorized by vote of the stockholders of the issuing public corporation at any annual meeting of stockholders or special meeting of stockholders. Such authorization shall require the affirmative vote of the holders of a majority of all of the shares entitled to vote generally in the election of directors, excluding interested shares. Interested shares shall be disregarded for purposes of determining a quorum and shall not be entitled to vote with respect to such authorization. If no such vote is adopted, such shares shall regain their voting rights upon transfer to another person unless such transfer constitutes a control share acquisition by the acquirer, in which event the voting rights of such shares shall be subject to the provisions of this chapter.

Section 6. If the jurisdiction under the laws of which an issuing public corporation is organized has adopted or adopts any law which expressly limits, restricts or otherwise affects the voting rights of any person in the event that such person acquires or proposes to acquire shares of such issuing public corporation which exceed or meet any level or range of ownership or voting powers specified in such law, and such law contains provisions that are expressly inconsistent with the provisions of this chapter as applicable to such issuing public corporation, the provisions of this chapter shall be inapplicable to such issuing public corporation to the extent necessary to resolve such inconsistency.

Section 7. No provisions of this chapter shall be deemed to limit the power of an association or trust to amend its instrument or declaration of trust to the extent otherwise lawful.

SECTION 3. Two years following the effective date of this act the governor, upon the advice of the secretaries of economic affairs and labor, shall submit to the general court a report evaluating the effect of chapters one hundred and ten D and one hundred and ten E of the General Laws on the commonwealth's economic well-being. Said report shall include, but not be limited to, the effect of said chapters on patterns and trends in mergers and acquisitions, jobs saved or retained, long-term investments in capital equipment and research and development, managerial accountability and shareholder voting rights. Said report shall also, include recommendations for legislative action to address any problems or opportunities referred to in said report.

House of Representatives, July 15, 1987.

Preamble adopted, George Keverian, Speaker.

In Senate, July 15, 1987.

Preamble adopted, William M. Bulger, President.

House of Representatives, July 16, 1987.

Bill passed to be enacted, George Keverian, Speaker.

In Senate, July 16, 1987.

Bill passed to be enacted, William M. Bulger, President.

July 21, 1987.

Approved,

at Eleven o'clock and 30 minutes, A. M.

Michael Dukakis, Governor.

-pp. 3+4

IN THE YEAR ONE THOUSAND NINE HUNDRED AND EIGHTY-EIGHT

AN ACT FURTHER REGULATING CONTROL SHARE ACQUISITIONS LAWS.

WHEREAS, The deferred operation of this act would tend to defeat its purpose, which is to make immediate technical corrections in the control share acquisitions laws, therefore it is hereby declared to be an emergency law, necessary for the immediate preservation of the public convenience.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. Section 1 of chapter 110D of the General Laws, as appearing in section 1 of Chapter 272 of the acts of 1987 is hereby amended by striking out subsection (a) and inserting in place thereof the following subsection: -

(a) "Associate", any person who directly or indirectly controls, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquisition, control as used in this clause meaning the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten per cent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person serves as trustee or in a similar fiduciary capacity; and any relative or spouse of a person, or any relative of such spouse, any one of whom has the same residence as such person.

SECTION 2. Paragraph (2) of subsection (c) of said section 1 of said Chapter 110D, as so appearing, is hereby further amended by striking out clause (i) and inserting in place thereof the following clause: -

(i) before June twenty-sixth, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares beneficial ownership of which is acquired before such date is within a range of voting power established by paragraph (1);

SECTION 3. Said section 1 of said Chapter 110D, as so appearing, is hereby further amended by striking out subsection (e), and inserting in place thereof the following subsection: -

(e)"Issuing public corporation", a corporation to which the provisions of chapter one hundred and fifty-six B apply pursuant to clause (a) of section three thereof, a gas or electric company or combined gas and electric company to which chapter one hundred and sixty-four applies pursuant to section three thereof or an association or trust which owns beneficially a majority of the common stock of such a company; provided, however, that such issuing public corporation has:

(i) two hundred or more stockholders of record; and

(ii) its principal executive office or substantial assets within the commonwealth; and

(iii) either: more than ten per cent of its stockholders of record residing within the commonwealth; or more than ten per cent of its issued and outstanding shares owned of record by residence of the commonwealth.

The record date for determining the percentages and numbers of stockholders and shares specified in this subsection shall be the last stockholder record date before the control share acquisition as to which the determination is being made or, if earlier, before the date on which a control share acquisition statement relating thereto is filed under the provisions of section three. A stockholder record date is the date fixed by the board of directors, or if applicable, the date when transfer books are closed by the board of directors, in connection with

determining stockholders entitled to notice of and vote at a meeting, or to consent or dissent, to recieve any dividend or other distribution, or for the purpose of any other lawful action. If a stockholder record date has not been fixed by the board of directors within the preceding four months, the determination shall be made as of the end of the issuing public corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the address appearing in the records of the corporation. Shares held of record by brokers or nominees shall be disregarded for purposes of calculating the percentages and numbers specified in this subsection. Any shares of an issuing public corporation allocated to the account of an employee or former employee, or beneficiary of an employee or former employee, of such corporation and held in a plan that is qualified under section 401(a) of the Internal Revenue Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee, former employee or beneficiary to whose account such shares are allocated.

In the case of an issuing public corporation which is an association or trust, references to articles of organizaiton mean the instrument or declaration of trust, references to by-laws include publicly announced resolutions of the directors, references to directors, the clerk and assistant clerk mean the individuals performing similar functions, and references to the corporation or such corporation mean the association or trust.

SECTION 4. Section 6 of said chapter 110D, as so appearing, is hereby amended by striking subsection (b) and inserting in place thereof the following subsection:—

(b) Notice of such redemption shall be given by the issuing public corporation not later than sixty days after the date on which the stockholders of the issuing public corporation voted not to authorize voting rights for the shares to be redeemed, or if no control share acquisition statement has been delivered prior to the date on which notice of redemption is given by the issuing public corporation, not

later than sixty days after the first date on which the board of directors of the issuing public corporation has actual knowledge of such control share acquistion.

SECTION 5. Section 1 of chapter 110E of the General Laws, as appearing in section 2 of said chapter 272, is hereby amended by striking out subsection(a) and inserting in place thereof the following subsection: -

(a) "Associate", any person who directly or indirectly countrols, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquistion, control as used in this clause meaning the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten percent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person serves as trustee or in a similar fiduciary capacity; and any relative or spouse of a person, or any relative of such spouse, any one of whom has the same residence as such person.

SECTION 6. Paragraph (2) of subsection (c) of said section 1 of said chapter 6 110E, as so appearing, is hereby further amended by striking out clauses (i) and (ii) inserting in place thereof the following two clauses: -

(i) before June twenty-sixth, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares beneficial ownership of which is acquired before such date is within a range of voting power established by paragraph (1);

(ii) pursuant to a contract to acquire shares existing before June twenty-sixth, nineteen hundred and eighty-seven;

SECTION 7. Said section 1 of said chapter 110E, as so appearing, is hereby further amended by striking out subsection (e) and inserting in place thereof the following subsection: -

(e) "Issuing public corporation", a corporation that has been established, organized or chartered under laws other than those of the commonwealth that has: -

(i) two hundred or more stockholders of record;

(ii) its principal executive office within the commonwealth and more of its employees or assets, including employees or assets of its majority owned subsidiaries, employed or located in the commonwealth than in any other state as of the end of any of its four fiscal quarters immediately preceding the control share acquisition as to which the determination is being made or, if earlier, immediately preceding the date on which a control share acquisition statement relating thereto is delivered pursuant to section three and

(iii) either: more than ten percent of its stockholders of record residing within the commonwealth; or more than ten percent of its issued and outstanding shares owned of record by residents of the commonwealth.

The record date for determining the percentages and numbers of stockholders and shares specified in this subsection shall be the last stockholder record date before the control share acquisition as to which the determination is being made or, if earlier, before the date on which a control share acquisition statement relating thereto is filed under the provisions of section three. A stockholder record date is the date fixed by the board of directors, or if applicable, the date when transfer books are closed by the board of directors, in connection with determining stockholders entitled to notice of vote at a meeting or to consent or dissent, to receive any dividend or other distribution, or for the purpose of any other lawful action. If a stockholder record date has not been fixed by the board of directors within the preceding four months, the determination shall be made as of the end of the issuing public corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the address appearing in the records of the corporation. Shares held of record by brokers or nominees shall be disregarded for purposes of calculating the percentages and numbers specified in this subsection. Any shares of an issuing public corporation allocated

to the account of an employee or former employee or beneficiary of an employee or former employee of such corporation and held in a plan that is qualified under section 401(a) of the Internal Revenue Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee, former employee or beneficiary to whose account such shares are allocated.

My name is Richard W. Southgate. The Committee has asked me to comment on House No. 3575, which would amend the Massachusetts Control Share Acquisitions Laws.

I am a lawyer in the firm of Ropes & Gray in Boston. I am chairman of the Special Committee of the Boston Bar Association which participated in drafting the Control Share Acquisitions Laws, which were passed last summer, and which are now Chapters 110D and 110E of the General Laws. As the Committee will recall, these chapters were based on a statute which regulates Indiana corporations, which was approved by the United States Supreme Court last April.

Last fall the Bar Committee submitted proposed technical corrections to Chapters 110D and 110E. Those resulted in House No. 3575. We propose one additional correction, copies of which are available to the Committee and its staff, which I request be included in the Bill.

As I mentioned to the Committee last summer, I am sure that the Committee appreciates that as practicing lawyers, the members of the Bar Committee represent clients who are interested in this legislation one way or another. For example, my law firm represents William Carter of which I am a director; we represent a committee of directors of Stop & Shop; we represent Gillette, and also business trusts which control gas and electric utilities - NEES and Eastern Gas. Another committee member is in a firm which represents Stop & Shop itself, and so forth.

I will speak very briefly.

House No. 3575 will not change the substance or the intent of Chapters 110D and E, which you will recall provide that if an acquisition is made of one-fifth, one-third or one-half of the stock of, broadly speaking, a publicly held corporation, the shares acquired may be voted only to the extent a majority of the disinterested shareholders decide they can be voted. House No. 3575 is lengthy, but that's because it repeats all of a section or subsection where only a few words are changed.

Section 1 of No. 3575 amends the definition of an associate, which is a person so closely connected with the acquirer that the associate's shares are counted with the acquirer's. Section 1 limits the Acts' definition of control to the determination of who is an associate, and as amended would also specify that the kind of trust which is an "associate" because of an acquirer's beneficial interest in it is a conventional trust (not a trust with transferable shares such as a voting trust or a business trust).

Section 2 of House No. 3575 clarifies the grandfathered status of shares acquired before the cut-off date, which was June 26, 1987.

Section 3 clarifies the legislative intent that in addition to business corporations, Chapter 110D covers gas and electric companies, and business trusts controlling gas

and electric companies. It also establishes the principal executive office as a Chapter 110D nexus test, and explains what certain terms used in the Chapter mean when they refer to business trusts controlling gas and electric companies.

Section 4 clarifies the timing of the redemption period for an acquirer who has lost his vote. Sections 5 through 7 add corresponding corrections to Chapter 110E, which applies to non-Massachusetts corporations. Section 7 also makes it clear that the nexus test in Chapter 110E includes assets of majority-owned subsidiaries.

I also have noted a couple of typo's in No. 3575, which I have given to the staff.

I will be glad to try to answer any questions.

HOUSE . . . . No. 3575

By Miss Travinski of Southbridge, petition of Marilyn L. Travinski, Lois G. Pines, Lucile P. Hicks, Daniel E. Bosley, Paul E. Caron and another relative to further regulating the control share acquisitions laws. Commerce and Labor.

The Commonwealth of Massachusetts

In the Year One Thousand Nine Hundred and Eighty-Eight.

AN ACT FURTHER REGULATING CONTROL SHARE ACQUISITIONS LAWS.

Whereas, The deferred operation of this act would tend to defeat its purpose, which is to make immediate technical corrections in the control share acquisitions laws, therefore it is hereby declared to be an emergency law, necessary for the immediate preservation of the public convenience.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. Section 1 of chapter 110D of the General Laws, as appearing in section 1 of Chapter 272 of the acts of 1987 is hereby amended by striking out subsection (a) and inserting in place thereof the following subsection: —

(a) "Associate", any person who directly or indirectly controls, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquisition, control as used in this clause meaning the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten per cent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person ~~[illegible]~~ as trustee or

not represented by transferable shares

serves

in a similar fiduciary capacity; and any relative or spouse of a person, or any relative of such spouse, any one of whom has the same residence as such person.

SECTION 2. Paragraph (2) of subsection (c) of said section 1 of said Chapter 110D, as so appearing, is hereby further amended by striking out clause (i) and inserting in place thereof the following clause: —

(i) before June twenty-six, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares beneficial ownership of which is acquired before such date is within a range of voting power established by paragraph (1);

SECTION 3. Said section 1 of said Chapter 110D, as so appearing, is hereby further amended by striking out subsection (c), and inserting in place thereof the following subsection: —

(c) "Issuing public corporation", a corporation to which the provisions of chapter one hundred and fifty-six B apply pursuant to clause (a) of section three thereof, a gas or electric company or combined gas and electric company [~~or combined gas and electric company~~] to which chapter one hundred and sixty-four applies pursuant to section three thereof or an association or trust which owns beneficially a majority of the common stock of such a company, provided, however, that such issuing public corporation has:

(i) two hundred or more stockholders of record; and

(ii) its principal executive office or substantial assets within the commonwealth; and

(iii) either: more than ten per cent of its stockholders of record residing within the commonwealth; or more than ten per cent of its issued and outstanding shares owned of record by residents of the commonwealth.

The record date for determining the percentages and numbers of stockholders and shares specified in this subsection shall be the last stockholder record date before the control share acquisition as to which the determination is being made or, if earlier, before the date on which a control share acquisition statement relating thereto is filed under the provisions of section three. A stockholder record date is the date fixed by the board of directors, or if

applicable, the date when transfer books are closed by the board of directors, in connection with determining stockholders entitled to notice of and vote at a meeting, or to consent or dissent, to receive any dividend or other distribution, or for the purpose of any other lawful action. If a stockholder record date has not been fixed by the board of directors within the preceding four months, the determination shall be made as of the end of the issuing public corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the address appearing in the records of the corporation. Shares held of record by brokers or nominess shall be disregarded for purposes of calculating the percentages and numbers specified in this subsection. Any shares of an issuing public corporation allocated to the account of an employee or former employee, or beneficiary of an employee or former employee, of such corporation and held in a plan that is qualified under section 401(a) of the Internal Revenue Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee, former employee or beneficiary to whose account such shares are allocated.

In the case of an issuing public corporation which is an association or trust, references to articles of organization mean the instrument or declaration of trust, references to by-laws include publicly announced resolutions of the directors, references to directors, the clerk and assistant clerk mean the individuals performing similar functions, and references to the corporation or such corporation mean the association or trust.

SECTION 4. Section 6 of said chapter 110D, as so appearing, is hereby amended by striking subsection (b) and inserting in place thereof the following subsection: —

(b) Notice of such redemption shall be given by the issuing public corporation not later than sixty days after the date on which the stockholders of the issuing public corporation voted not to authorize voting rights for the shares to be redeemed, or if no control share acquisition statement has been delivered prior to the date on which notice of redemption is given by the issuing public corporation, not later than sixty days after the first date on

which the board of directors of the issuing public corporation has actual knowledge of such control share acquisition.

SECTION 5. Section 1 of chapter 110E of the General Laws, as appearing in section 2 of said chapter 272, is hereby amended by striking out subsection (a) and inserting in place thereof the following subsection: —

(a) "Associate", any person who directly or indirectly controls, or is controlled by, or is under common control with, a person or who is acting or intends to act jointly or in concert with a person in connection with a control share acquisition, control as used in this clause meaning the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract or otherwise; any corporation or organization of which a person is an officer, director or partner or in which a person performs a similar function; any direct or indirect beneficial owner of ten percent or more of any class of equity securities of a person; any trust or estate in which a person has a beneficial interest or as to which a person serves as trustee or in a similar fiduciary capacity; and any relative or spouse of a person, or any relative of such spouse, any one of whom has the same residence as such person.

...t represented
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...ble shares

SECTION 6. Paragraph (2) of subsection (c) of said section 1 of said chapter 110E, as so appearing, is hereby further amended by striking out clause (i) and (ii) inserting in place thereof the following two clauses: —

(5)

(i) before June twenty-sixth, nineteen hundred and eighty-seven; provided, however, that the aggregate of shares beneficial ownership of which is acquired before such date is within a range of voting power established by paragraph (1);

(ii) pursuant to a contract to acquire shares existing before June twenty-sixth, nineteen hundred and eighty-seven;

SECTION 7. Said section 1 of said chapter 110E, as so appearing, is hereby further amended by striking out subsection (c) and inserting in place thereof the following subsection: —

(c) "Issuing public corporation", a corporation that has been established, organized or chartered under laws other than
of the commonwealth that has: —

(i) two hundred or more stockholders of record;

(ii) its principal executive office within the commonwealth
more of its employees or assets, including employees or asse
its majority owned subsidiaries, employed or located in the c
monwealth than in any other state as of the end of any of its
fiscal quarters immediately preceding the control share acq
tion as to which the determination is being made or, if ea
immediately preceding the date on which a control share aq
tion statement relating thereto is delivered pursuant to sec
three and

(iii) either: more than ten percent of its stockholders of re
residing within the commonwealth; or more than ten percen
its issued and outstanding shares owned of record by resid
of the commonwealth.

The record date for determining the percentages and numb
of stockholders and shares specified in this subsection shall be
last stockholder record date before the control share acquisit
as to which the determination is being made or, if earlier, bef
the date on which a control share acquisition statement rela
thereto is filed under the provisions of section three. A stockhol
record date is the date fixed by the board of directors o
applicable, the date when transfer books are closed by the bo
of directors, in connection with determining stockholders enti
to notice of vote at a meeting or to consent or dissent, to rec
any dividend or other distribution, or for the purpose of any ot
lawful action. If a stockholder record date has not been fixed
the board of directors within the preceding four months,
determination shall be made as of the end of the issuing pul
corporation's most recent fiscal quarter.

The residence of each stockholder is presumed to be the add
appearing in the records of the corporation. Shares held of rec
by brokers or nominees shall be disregarded for purposes of c
culating the percentages and numbers specified in this subsectio
Any shares of an issuing public corporation allocated to t
account of an employee or former employee or beneficiary of
employee or former employee of such corporation and held in
plan that is qualified under section 401(a) of the Internal Reven

Code of 1986, as amended, and is a defined contribution plan within the meaning of section 414(i) of said Code shall be deemed, for the purposes of clause (iii), to be held of record by the employee, former employee or beneficiary to whose account such shares are allocated.

Explanation of proposed act
further regulating control share acquisitions

February 16, 1988

The proposed Act (as amended) makes technical corrections. A summary follows:

Proposed Act Section	Effect on Chapter 110D or Chapter 110E
1	Limits definition of control in Section 1(a) of Chapter 110D to determination of who is an "associate". Clarifies that the kind of trust which is an "associate" because of a person's beneficial interest is a conventional trust (not a trust with transferable shares).
2	Clarifies the intended grandfathered status for pre-effective date ownership in Section 1(c)(2)(i) of Chapter 110D by adding a beneficial ownership standard and by referring to any of the ranges of voting power established by Section 1(c)(1).
3	Clarifies the legislative intent in Section 1(e) that Chapter 110D applies to business corporations, gas and electric companies and business trusts controlling gas and electric companies. Also establishes principal executive office as a Chapter 110D nexus test in Section 1(e)(ii), rather than principal place of business or principal office. This clarification makes Chapter 110D consistent with Chapters 110C and 110E.

Proposed Act Section	Effect on Chapter 110D or Chapter 110E
	Also clarifies certain references in Section 1(e) to beneficiaries and former employees under ESOPs and other benefit plans.
	Finally, adds a paragraph at the end of Section 1(e) to explain how Chapter 110D's references to articles of organization, by-laws, directors, clerk and assistant clerk work in the case of business trusts controlling gas and electric companies.
4	Makes it clear in Section 6 of Chapter 110D that notice of redemption may be given not later than 60 days after the directors learn of a control share acquisition.
5	Limits definition of control in Section 1(a) of Chapter 110E to determination of who is an "associate".
	Clarifies that the kind of trust which is an "associate" because of a person's beneficial interest is a conventional trust (not a trust with transferable shares).
	Same as changes for Chapter 110D.
6	Clarifies the intended grandfathered status for pre-effective date ownership in Section 1(c)(2) by adding a beneficial ownership standard and by referring to any of the ranges of voting power established by Section 1(c)(1). (Same as change for Chapter 110D.)

Proposed Act Section	Effect on Chapter 110D or Chapter 110E
	Makes Chapter 110E consistent with Chapter 110D by referring to a contract to acquire shares in Section 1(c)(2)(ii).
7	Makes clear that the asset nexus text in Section 1(e)(ii) of Chapter 110E includes assets of majority owned subsidiaries. Also corrects last sentence of next to last paragraph of Section 1(e) of Chapter 110E so as to refer to an issuing public corporation. Finally, clarifies certain references in the last paragraph of Section 1(e) of Chapter 110E to an employee, former employee or beneficiary under ESOPs and other benefit plans.

Richard W. Southgate

Proposed Amendment to the Pending Act Further
Regulating Control Share Acquisitions Laws

February 16, 1988

Amend the definition of "Associate" in Sections 1 and 5 of the pending Act by adding the phrase "not represented by transferable shares" in the third clause, so that the clause reads as follows:

> "any trust or estate in which a person has a beneficial interest not represented by transferable shares or as to which a person serves as trustee or in a similar fiduciary capacity."

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

CHAEL S. DUKAKIS
GOVERNOR
OSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

MEMORANDUM

TO: Commission members

FROM: Secretary Joseph D. Alviani

DATE: July 12, 1988

RE: FEDERAL ANTI-TAKEOVER ACTIVITY - UPDATE

This memo is to provide you with a brief summary of recent federal legislative and regulatory action, Senator Armstrong's amendments to the Proxmire Tender Offer Reform Act (S. 1323) and the new Securities and Exchange Commission (SEC) rule concerning shareholder voting rights. Both actions raise significant issues concerning the state role in corporate governance, particularly in the context of state regulation of takeovers.

Briefly, the Armstrong amendments, as filed, would prohibit golden parachutes, poison pills and greenmail absent prior shareholder approval. These amendments appear to give the SEC virtually unlimited power in interpretation and implementation, apparently including the authority to grant waivers on a case-by-case basis. Senator Proxmire requested a count in the Senate to determine support for the Armstrong amendments following a 97-1 vote for the golden parachute amendment on June 15 followed by a 40-57 vote against Proxmire's motion to table the amendments. (The sole dissenting vote on the parachute issue was Senator Roth of Delaware who argued against them on a states' rights basis.) Despite Proxmire's opposition to these takeover practices and provisions in S.1323 as drafted that would limit their use, Proxmire has stated that he would prefer to withdraw the entire bill from Senate consideration rather than see it go forward with the Armstrong amendments. Compromise language that would send these issues to the SEC for a one-year study is currently being developed.

Of more immediate significance is the SEC's new "Shareholder Disenfranchisement Rule" that would prevent public corporations from issuing new classes of stock that would diminish the voting rights of their existing shareholders. This rule, effective July 8, is viewed by many as a "one-share/one-vote" requirement. However, it contains a number of exceptions, including:

1) Companies with classes of stock with different voting rights as of July 8 are "grandfathered" and may continue to trade on public exchanges.

2) Companies making initial offerings may issue some shares with greater voting powers than others given adequate disclosure.

3) Companies may issue securities for any purpose, including financing a merger or acquisition, if the voting rights of new shares are not greater than the per share voting rights of any class of outstanding stock.

4) Corporate actions taken pursuant to an Indiana-type takeover law, such as Chapter 110D of the Massachusetts Control Share Acquisition Law, are specifically exempted. However, foreign corporations seeking protection under the Massachusetts law (M.G.L. c 110E) can no longer list or trade their shares on national exchanges.

5) The rule does not apply to companies incorporated in countries outside the U.S. even though they trade on U.S. exchanges and may be headquartered in the U.S.

The principal issue raised by both the Armstrong amendments and the new SEC rule is the usurpation of state regulatory authority over corporate governance, an area traditionally viewed as within the exclusive jurisdiction of the states. Piecemeal federal regulation of state created entities has long been a very controversial issue. Congress has never been able to enact a federal "incorporation" law, despite several attempts and there is no indication that Congress is considering such a step in the future. The other issue raised by both actions is the wisdom of prohibiting certain defensive tactics, no matter how abusive they may appear, without taking effective parallel actions to curb abuses by raiders. The end result, intended or not, will most probably be to facilitate takeovers. This would be consistent with the strong pro-takeover positions of Senator Armstrong and the SEC. However, it not clear that it is in our long-term economic interest. Absent a comprehensive federal response balancing the interests of labor, business, shareholders and other corporate stakeholders, usurpation of state authority to regulate takeovers, either directly or through corporate governance provisions, could increase the number of takeovers and provide disincentives to making the long-term investments essential to the competitiveness and growth of the American economy.

COMPARISON OF PRINCIPAL BILLS TO AMEND WILLIAMS ACT

DISCLOSURE PREEMPTED

	Issue	Present Law	Dingell/Markey H.R. 2172	Proxmire/Riegle S. 1323	BRT Position
1.	13(d) threshold and window (ownership level/filing time)	After acquiring 5%, must notify in 10 days. Each addtl 1% reportable	5%/24 hours; no addl purchase for 2 bus. days	3%/close next bus. day; no purchase until file	2%/2 days
2.	Require broader disclosure	Minimal disclosure including financing but exempting banks	"Plain English" statement must be filed spelling out terms of bid, including junk bond financing, and participation of others	Discussions with others, fees/expenses incurred, all sources of financing, plans for investment or control	-----
3.	Expand definition of group	2 or more act as a group SEC must detect and prove	SEC and courts may consider extent to which group acted in "consciously concerted" manner	"Consciously parallel" actions	Must report contacts with others filing 13(d) reports. Permit SEC to use standard of "conscious parallelism" in determining group activity
4.	Extend minimum offering period	20 business days	60 calendar days	35 business days	Either 35 bus. days or 60 calendar days
5.	Expand enforcement	Private right of action for fraud only. Limited remedies. Light penalties	Civil penalties not to exceed 1% of value of securities for each day of late filing	Private right of action for intentional disclosure, tender, margin violations. If say investement & change, no tender offer for 6 mos.	Substantial civil penalties for late or false filing
6.	Limit open market purchases	Prohibited during "tender offer"	Acquisition above 15% must be by tender offer	Above 15%, must be by tender offer	Above 15%, must be by tender offer

DEFENSIVE TACTICS

PREEMPTION DEPENDS ON LANGUAGE

7.	Restrict 2 tier offers	Pro rata acceptance required	-----	-----	Above 15% must be by tender for any and all shares at same price
8.	Restrict greenmail (Max % shares repurchasable; min. holding period to exempt; other provisions)	No specific provisions	3%/2 years unless similar offer to all holders or approved by shareholders	3%/6 months unless shareholders approve or by self-tender offer	Prohibit receipt of greenmail payments; disgorge any profits to issuer
9.	Restrictions on golden parachutes during offer	No specific provisions	Cannot adopt during pendency of tender offer. Cannot pay in excess of IRS guidelines. Grandfather clause for previously adopted parachutes	Yes	Covered by IRS regulations and the business judgment rule
10.	Restrictions on poison pills	No specific prov. SEC considering ban	Cannot establish or implement during pendency of tender offer unless approved by shareholders	Cannot establish during offer	Covered by state law
11.	One share/one vote	No requirement	Prohibits trading of company's shares on a national exchange unless each voting share has one voate and all common stock is voting. Full compliance within 3 years of enactment	-----	Oppose federal requirement. Voting rights covered by state law. Rules for listing determined by excahges
12.	Limit junk bonds	No specific provisions except Federal Reserve on shell corporations	-----	-----	-----
13.	Limit leveraged buyouts	No specific provisions	-----	-----	-----

14. Restrict financing options	No restrictions on use of issuer assets; "highly confident" letter common	-----	-----	Oppose federal regulation of leverage
---> 15. Reaffirm role of states	CTS v. Dynamics upheld Indiana statute thereby affirming state role on corporate governance	No. Creates open-ended SEC authority to proscribe defensive tactics. Expands SEC's general authority to make rules. Expands purpose of Act to include regulation of fair contests for control. Net effect is federal pre-emption	Yes <u>MARKUP: All language re state roles or preemption deleted; defensive tactics language weakened</u>	Yes. Support language in Proxmire bill affirming primacy of state laws in matters of corporate governance and internal affairs.
16. Change ERISA requirements	No specific provisions	-----	Cannot use pension surpluses for takeovers; fiduciary can consider long-term	Cannot use pension surpluses for akeovers; fiduciary permitted to consider long-term in deciding whether to tender shares
17. Increase insider trading penalties	5 years &/or $100,000	-----	10 years &/or $1,000,000; minimum 1 yr for perjury/ obstruction of justice	-----
18. Sweeping the street	-----	Requires 30-day "cooling off" period before person withdrawing a tender offer may re-enter the market	-----	Cooling off period not necesary if "any or all" requirement is in bill
19. Defensive tactics	-----	Open-ended authority to SEC to proscribe any defensive tactics during tender offer which frustrates purposes of the Act, to include poison pills, lock-ups	-----	Opposed to granting SEC open-ended authority

		and tin parachutes		
20. Trading halts	-----	Provides that trading halts on a national securities exchange must be observed by the third market	-----	-----
21. Access to proxy machinery	-----	Requires that owners of 3% (or $500,000) of a company's shares, whichever is greater, have full access to proxy machinery for director nominees	-----	Proxy system works well. No need for change
22. Market rumors		Requires companies to give a definite "yes" or "no" to official inquiries concerning takeover activity. "No comment" not permitted	-----	-----
23. Confidentiality of proxy voting		-----	-----	Proxy system works well. No need for change
24. Other		-----	Require registration of arbitrageurs	-----

Text of the Rule

Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 240 - General Rules and Regulations. Securities Exchange Act of 1934.

1. The authority citation for Part 240 is amended by adding the following citation:

Authority: Sec. 23, 48 Stat. 901, as amended (15 U.S.C. § 78w) *** § 240.19c-4 also issued under Sections 6, 11A, 14, 15A, 19 and 23 of the Securities Exchange Act of 1934 (15 U.S.C. §78o-3, and 78s).

2. By adding §240.19c-4 as follows:

§240.19c-4. Governing certain listing or authorization determinations by national securities exchanges and associations.

(a) The rules of each exchange shall provide as follows: No rule, stated policy, practice, or interpretation of this exchange shall permit the listing, or the continuance of the listing, of any common stock or other equity security of a domestic issuer, if the issuer of such security issues any class of security, or takes other corporate action, with the effect of nullifying, restricting or disparately reducing the per share voting rights of holders of an outstanding class or

classes of common stock of such issuer registered pursuant to Section 12 of the Act.

(b) The rules of each association shall provide as follows: No rule, stated policy, practice, or interpretation of this association shall permit the authorization for quotation and/or transaction reporting through an automated inter-dealer quotation system ("authorization"), or the continuance of authorization, of any common stock or other equity security of a domestic issuer, if the issuer of such security issues any class of security, or takes other corporate action, with the effect of nullifying, restricting, or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock of such issuer registered pursuant to Section 12 of the Act.

(c) For the purposes of paragraphs (a) and (b) of this section, the following shall be presumed to have the effect of nullifying, restricting, or disparately reducing the per share voting rights of an outstanding class or classes of common stock:

(1) corporate action to impose any restriction on the voting power of shares of the common stock of the issuer held by a beneficial or record holder based on the number of shares held by such beneficial or record holder, unless such restriction is required by statute of the issuer's state of incorporation;

(2) corporate action to impose any restriction on the voting power of shares of the common stock of the issuer held by a beneficial or record holder based on the length of time such shares have been held by such beneficial or record holder;

(3) any issuance of securities through an exchange offer by the issuer for shares of an outstanding class of the common stock of the issuer, in which the securities issued have voting rights greater than or less than the per share voting rights of any outstanding class of the common stock of the issuer.

(4) any issuance of securities pursuant to a stock dividend, or any other type of distribution of stock, in which the securities issued have voting rights greater than the per share voting rights of any outstanding class of the common stock of the issuer.

(d) For the purpose of paragraphs (a) and (b) of this section, the following, standing alone, shall be presumed not to have the effect of nullifying, restricting, or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock:

(1) the issuance of securities pursuant to an initial registered public offering;

(2) the issuance of any class of securities, through a registered public offering, with voting rights not

greater than the per share voting rights of any outstanding class of the common stock of the issuer;

(3) the issuance of any class of securities to effect a bona fide merger or acquisition, with voting rights not greater than the per share voting rights of any outstanding class of the common stock of the issuer.

(4) corporate action taken pursuant to state law requiring a state's domestic corporation to condition the voting rights of a beneficial or record holder of a specified threshold percentage of the corporation's voting stock on the approval of the corporation's independent shareholders.

(e) Definitions

The following terms shall have the following meanings for purposes of this section, and the rules of each exchange and association shall include such definitions for the purposes of the prohibition in paragraphs (a) and (b), respectively, of this section:

(1) The term "Act" shall mean the Securities Exchange Act of 1934, as amended.

(2) The term "common stock" shall include any security of an issuer designated as common stock and any security of an issuer, however designated, which, by statute or by its terms, is a common stock (e.g., a security which entitles the holders thereof to vote

generally on matters submitted to the issuer's security holders for a vote).

(3) The term "equity security" shall include any equity security defined as such pursuant to Rule 3a11-1 under the Act [17 C.F.R. § 240.3a11-1].

(4) The term "domestic issuer" shall mean an issuer that is not a "foreign private issuer" as defined in Rule 3b-4 under the Act [17 C.F.R. § 240.3b-4].

(5) The term "security" shall include any security defined as such pursuant to Section 3(a)(10) of the Act, but shall exclude any class of security having a preference or priority over the issuer's common stock as to dividends, interest payments, redemption or payments in liquidation, if the voting rights of such securities only become effective as a result of specified events, not relating to an acquisition of the common stock of the issuer, which reasonably can be expected to jeopardize the issuer's financial ability to meet its payment obligations to the holders of that class of securities.

(6) the term "exchange" shall mean a national securities exchange, registered as such with the Securities and Exchange Commission pursuant to Section 6 of the Act, which makes transaction reports available pursuant to Rule 11Aa3-1 under the Act [17 C.F.R. § 240.11Aa3-1]; and

(7) the term "association" shall mean a national securities association registered as such with the Securities and Exchange Commission pursuant to Section 15A of the Act.

(f) An exchange or association may adopt a rule, stated policy, practice, or interpretation, subject to the procedures specified by Section 19(b) of the Act, specifying what types of securities issuances and other corporate actions are covered by, or excluded from, the prohibition in paragraphs (a) and (b) of this section, respectively, if such rule, stated policy, practice, or interpretation is consistent with the protection of investors and the public interest, and otherwise in furtherance of the purposes of the Act and this section.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR

JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

June 28, 1988

The Honorable Edward M. Kennedy
United States Senate
315 Russell Office Building
Washington, DC 20510

Dear Senator Kennedy:

I am writing to commend you on your efforts in developing responsible legislation to regulate the abuses and excesses associated with hostile takeovers. In addition, I would like to express the Commonwealth's interest in and position on the several amendments to S. 1323 proposed by Senator Armstrong, with particular emphasis on the issue of federal pre-emption of state regulatory authority in this area.

The competitiveness and growth of the American economy, and the well-being of our citizens, depend on long-term investments in physical plant, research and development and training of workers. While takeovers are not a new phenomenon, their significance in shaping corporate strategic planning and the operation of financial markets has substantially increased over the past two decades. Now even the largest American firms consider themselves vulnerable to takeover attempts. Takeovers can be important and useful mechanisms for transferring corporate control, thus ensuring corporate accountability, or they can be entirely too efficient mechanisms for short-term financial speculation. Either way, successful takeovers and takeover attempts are often followed by major organizational changes for the target company, resulting in shifts in management, layoffs and reduced investments in areas critical to long-term competitiveness. The prospect of such changes, combined with perceived abuses on Wall Street and the high level of debt incurred in both takeovers and takeover defenses, have created an environment that encourages states to regulate takeover activity to protect not only shareholder and management investments, but also the investments of labor and the public sector in long-term economic growth.

Corporations seeking protection from hostile takeovers first turned to the federal government for help. In response, Congress passed the Williams Act in 1968, designed to provide investors with sufficient information to enable them to act in their own interest, while creating a "level playing field" between targets and bidders. Congress specifically rejected provisions that would have given either targets or bidders an advantage over the other. As you know, many corporations felt the federal response was inadequate and turned to the states for added protection. The states' initial response was to enact a "first generation" of takeover laws modeled, for the most part, on the

Williams Act, but requiring greater disclosure. The U.S. Supreme Court found this "first generation" of laws unconstitutional because they conflicted with the Williams Act by favoring target interests over those of shareholders and were a substantial impediment to interstate commerce. However, the Court did not hold that all state takeover regulation would be pre-empted by federal law or violate the commerce clause. In response to the continuing needs of business, labor and shareholders, the states began developing a "second generation" of takeover laws through a variety of mechanisms including the modification of specific corporate governance provisions affecting "internal affairs," the only approach explicitly upheld by the Supreme Court to date.

Ideally, an effective federal response would deter speculative takeovers by balancing the short-term, profit-making incentives provided by financial markets with the national economic need for long-term investment in people, plant and innovation. This can only be achieved through a comprehensive federal response that distinguishes between speculative and productive takeovers and maintains the "level playing field" between bidders and targets central to the Williams Act. If such a federal response could be developed, complete pre-emption of state regulation of takeovers would be an important component to ensure that the needs of all workers, managers and shareholders throughout the nation were met. Due to the complexity of the issues raised by the regulation of takeovers and the limited availability of reliable information on the impacts of various types of responses, it is not clear that any of the bills currently before Congress would constitute an adequate response. Until such a comprehensive response can be developed, states can serve as useful laboratories for evaluating the relative effectiveness of different approaches to this issue.

In this context, the amendments to S. 1323 proposed by Senator Armstrong raise a number of concerns. Although these amendments focus on what are generally viewed as defensive abuses or excesses used to protect "entrenched management," the requirement for shareholder ratification and the broad grant of discretionary authority to the Securities and Exchange Commission for their interpretation and implementation raise the much larger issue of federal pre-emption of state regulation of corporate governance. If adopted, the Armstrong amendments would set a precedent for selective pre-emption of state regulatory authority over the "internal affairs" of entities that are uniquely creatures of state law. This is of particular concern in light of anticipated consideration of a one-share/one-vote requirement for all publicly traded securities which, if adopted, would pre-empt "second generation" takeover laws based on the Indiana-type control share acquisition model. As of this date, 21 states, including Massachusetts, have enacted such laws. The Armstrong amendments also raise concerns about their effect on the "level playing field" central to the Williams Act. It would appear that the Armstrong amendments could be very effective in prohibiting the use of golden parachutes, poison pills and greenmail as defenses. However, it is less clear that any of the bills currently before Congress would be as effective in prohibiting excessive and abusive tactics of bidders. The rate at which new financial innovations are developed to facilitate the takeover process makes any attempt to regulate the transactions themselves extremely difficult. Although significant benefits could accrue from the prohibition of certain defensive tactics, if the result is a "playing field" tilted towards bidders, significant incentives for short-term, speculative takeovers could be created at substantial cost to the long-term competitiveness and sustained growth of the American economy.

This potential makes continued state authority to regulate takeover activity even more important to protect the interests of workers, management, shareholders and the public sector.

Again, let me commend you on your efforts in producing legislation in this area critical to the economic future of this nation. If I can assist you in any way please do not hesitate to call me.

Sincerely,

Joseph D. Alviani
Secretary

JDA:BW

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M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: STATE HART-SCOTT-RODINO AND STATE CLAYTON SECTION 7 ACTS

GENERAL PROPOSAL:

Enact a modified Hart-Scott-Rodino Act (H-S-R) to increase disclosure requirements for firms purchasing Massachusetts businesses and expand state antitrust enforcement powers through an amendment to existing state antitrust provisions to permit the Attorney General to prevent "anti-competitive" mergers or acquisitions before they are completed.

BACKGROUND:

Under federal law, section 7 of the Clayton Act, mergers can be prevented - before they are consummated - where their effect "may be substantially to lessen competition or tend to create a monopoly in any line of commerce in any section of the country." In 1976, Congress amended Clayton section 7 with the Hart-Scott-Rodino Antitrust Improvements Act (H-S-R) which made two important changes for Commission purposes: 1) required pre-merger notification to the Federal Trade Commission and a waiting period by parties to mergers of specified sizes; and 2) authorized and established procedures for state attorneys general to enforce Clayton 7 for antitrust violations causing injury to state citizens. Following enactment of H-S-R it was FTC practice to share information collected through H-S-R filings with the states to enable them to evaluate the potential injury to state citizens. However, in 1984 the FTC reversed this practice on the grounds that it lacked the authority to share this information, a position that has been upheld by several Circuit court decisions. The end result is that although state attorneys general have the statutory authority to enforce Clayton 7 in federal court, in most cases they lack timely information to do so.

A state H-S-R Act could exactly mirror its federal counterpart so that the buyer of a Massachusetts firm would only have to make a duplicate filing of the information it filed with the FTC. However, it could also be structured with lower trigger thresholds for the notice requirement. Any burden on acquiror created by differential trigger thresholds could be mitigated by the use of a "short-form" filing with state officials which gave them discretion to request a more detailed filing if warranted. The use of such a short-form mechanism would require quite specific regulatory guidelines to ensure uniform application of standards. Whatever the trigger thresholds, a state H-S-R provision would ensure that the Attorney General had timely information to evaluate the competitive impact of a merger or acquisition on our economy and Massachusetts consumers.

The Massachusetts antitrust law, M.G.L. c.__, does not include a Clayton 7 - type provision. Modeled for the most part on the Sherman Act, it deals primarily with restraints of trade and monopolization, with certain provisions dealing with price discrimination included. Because the state lacks independent jurisdiction through its own Clayton 7 provision, the Attorney General must go to federal court to enjoin a merger or acquisition which he feels will injure competition within the state. Moreover, Clayton 7 establishes the remedy to parties injured by an "anti-competitive" merger or acquisition. A parallel state provision would permit the Attorney General to file in state court which might be expected to be less hostile to antitrust actions than the federal courts. It would also permit the Attorney General to file in both federal and state courts requesting different remedies.

It would appear that the principal justification for state action in the antitrust area is perceived failure of the federal to adequately enforce federal antitrust law. Such enforcement would require aggressive review of H-S-R filings at the federal level and, for practical purposes, sharing of that information with the states simply to expand enforcement capacity. The above proposals are designed to address the perceived failure to adequately enforce the Clayton Act and refusal by the FTC to share H-S-R information critical to state enforcement of Clayton 7. Recommendations for state action should be considered in conjunction with recommendations for federal action and the likelihood for their rapid implementation.

Attached please find a more detailed briefing memo on the H-S-R and Clayton 7 proposals for commission recommendations for state action provided by Barbara Anthony from Secretary Gold's office.

RECOMMENDATION A:

Establish state H-S-R review process for anticipated mergers or acquisitions using identical triggers to the federal H-S-R standards to require buyers of Massachusetts firms to file duplicate notice with state antitrust enforcement officials.

PROS:

Mergers/acquisitions that could harm consumers by increasing prices or reducing choices by lessening competition would automatically be brought to the attention of state officials permitting timely action whether through further investigation, an injunction or negotiation to lessen the most harmful effects. This would extend to intrastate mergers not within federal jurisdiction.

The time period for antitrust review could provide targets with added time to evaluate the offer and develop options.

Would put state on notice of potential stakeholder dislocations.

CONS:

Review of H-S-R filings would probably require added resources, both personnel and money, in the Office of the Attorney General or, perhaps, the Secretary of State.

Use of federal review time frames will require staff turnaround of filings within 30 days for mergers and within 15 days for tender offers.

There could be substantial political pressure to use this review mechanism as a barrier to takeovers.

Traditional H-S-R review is limited to the potential injury to consumers caused by reduced competition and would not include the impact on employees, communities, suppliers, creditors or shareholders.

RECOMMENDATION B:

Establish H-S-R review process for anticipated mergers or acquisitions of firms with a specific amount of Massachusetts-based assets, perhaps 5% or $X million, with "short-form" procedure outlined above where this trigger does not coincide with the federal trigger, with extended review periods and with disclosure to include a "community impact" statement concerning anticipated layoffs and closings.

PROS:

Same as above with following additions:

Would expand application of disclosure requirements to mergers and acquisitions of smaller firms and of subsidiaries of non-Massachusetts parent corporations which might not have any impact on national markets but which might still have local competitive impacts.

Would provide state officials with more time to effectively review proposed mergers/acquisitions for their potential injury to consumers and competition.

Would provide state officials with information needed to evaluate potential dislocations of stakeholders.

CONS:

Same as (A) with following modifications:

Although state officials would have additional information re "community impact," Clayton 7 would not be an appropriate vehicle for acting on that information except to the extent that the transaction was viewed as injuring consumers and in the process of negotiating a settlement the Attorney General could incorporate stakeholder interests into a resolution that protected consumer interests.

Accuracy of "community impact" statements would be questionable with no real incentive to provide accurate information. In reality, a good faith disclosure of potential layoffs and/or closings could be completely inaccurate due to the inability of the buyer to accurately assess corporate operations from "outside." Since H-S-R is a pre-merger notification mechanism, it is not useful for ongoing updates of personnel plans since there is no ongoing jurisdiction.

Use of a "community impact" statement as the basis for barring a merger or acquisition raises all the constitutional problems of the "first generation" anti-takeover statutes.

<u>RECOMMENDATION C</u>:

Expand state antitrust enforcement authority adding a state Clayton section 7 provision to enable the Attorney General to enjoin in state court a merger or acquisition where the effect "may be substantially to lessen competition or tend to create a monopoly in any line of commerce in Massachusetts."

PROS:

Would authorize attorney general to enjoin any merger or acquisition where consumers would be injured due to a lessening in competition in Massachusetts markets.

Would strengthen the state's negotiating position in structuring the terms and conditions of a merger or acquisition suspected of having an "anti-competitive" effect.

CONS:

Would probably be opposed by most business and commercial interests as intrusive and as an undue burden on their ability to buy and sell corporate assets.

Could be viewed by many as redundant given the Attorney General's authority to sue under federal law.

As the trend in an increasingly global economy is to view markets as international in scope, enacting legislation that is explicitly limited to state markets could raise significant policy problems. Unless guidance is provided in the statute, the interpretation of what is within the proper scope of the statute will rest with the courts.

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ICHAEL S DUKAKIS
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PAULA W GOLD
SECRETARY

MEMORANDUM

TO: Barbara Waters

FROM: Barbara Anthony

RE: Antitrust-Related Recommendations for Takeover Commission Consideration

DATE: August 22, 1988

This memo is is in response to your request for descriptions of certain recommendations for possible state action that were mentioned in Secretary Alviani's August 8th memo to the Governor. These areas are: (1) Increased disclosure requirements for firms purchasing Massachusetts businesses, perhaps a modified version of Hart-Scott-Rodino; (2) Expanded state antitrust powers, perhaps modeled on section 7 of the Clayton Act which would use information obtained through increased disclosure requirements, to enjoin mergers or takeovers that may tend substantially to lessen competition in Massachusetts markets; and (3) Recommendations at the federal level to require that federal antitrust authorities share Hart-Scott-Rodino information with affected states and to extend the time periods for federal review of merger disclosure materials. Please feel free to make changes as you deem appropriate to expedite the work of the Commission.

1. INCREASED DISCLOSURE REQUIREMENTS: How This Would Work

Background:

As you know, under federal law, Section 7 of the Clayton Act, mergers are prohibited -- before they are consummated -- where the effect "may be substantially to lessen competition, or to tend to create a monopoly"... "in any section of the country." It is often said that the purpose behind section 7 is to prevent, in their incipiency, mergers that create undue concentrations of power and harm consumer welfare. Consumer welfare is harmed when a decrease in competition leads to higher consumer prices and/or fewer consumer choices. While this results most frequently from mergers between competitors, it can also result from certain vertical integrations or conglomerate acquisitions as well.

In 1976, Congress amended Section 7 of the Clayton Act, when it

passed the Hart-Scott-Rodino Antitrust Improvements Act which required premerger notification and disclosures to federal antitrust agencies prior to the consummation of a merger or the completion of a tender offer. The information provided by acquiring and acquired firms under H-S-R gives federal authorities necessary information with which to evaluate the competitive impacts of a merger or takeover. Thus, federal antitrust agencies have information up front about the potential harm to consumers that is likely to flow from a proposed merger.

Before 1984, the FTC released information filed under H-S-R to state attorneys general for use in law enforcement proceedings. The FTC reversed its practice in 1984 on the grounds that it did not have the authority to release the information. While several attorneys general sued to reverse this ruling, two federal circuit courts upheld the Commission's interpretation. Thus, state attorneys general are denied access to information filed in compliance with H-S-R. This means that even though a state is entitled to seek to enjoin a merger under federal law (state attorneys general may enforce section 7 of the Clayton Act and may also seek to recover damages on behalf of a state and its consumers), it is not entitled to obtain from federal authorities the information necessary to analyze the merger in the first instance.

Although there are cases where parties to a merger voluntarily provide the states with their H-S-R disclosures (Campeau/Federated was one such instance), as a general rule, premerger information is not given to the states by parties on a voluntary basis prior to completion of the transaction. If a state finds out about a pending merger or takeover that may constitute a violation of state antitrust law, a state, such as Massachusetts, can use its power to issue civil subpoenas to obtain relevant information. The problem with this approach is that a state is always playing "catch-up". A merger or takeover may be well on its way to consummation before a state learns about a proposed transaction that affects its markets or actually receives the information sought through civil subpoenas.

What Benefits Would Come From a Modified H-S-R for Massachusetts?

(1) The first benefit to flow from premerger screening is that mergers or takeovers that are harmful to consumers because they might result in increased prices or fewer choices will be flagged for state authorities; although premerger screening is traditionally limited to examining harm to consumers caused by a lessening of competition, a modified version of H-S-R could also include some form of community impact statement;

(2) State authorities would then be in a position to take one or more courses of action to protect the interests of consumers: the state could investigate further; could seek to enjoin a merger based on information provided by the parties; could negotiate with the parties to divest the anticompetitive, harmful aspects of the

merger or to reach some other acceptable solution in return for not seeking to enjoin the merger;

(3) An indirect benefit is that the time frame required for review could provide the target of a unfriendly takeover with an opportunity to consider its options and to take appropriate action if such is desirable;

(4) A modified H-S-R for Massachusetts would result in flagging any potentially harmful intrastate mergers or takeovers that would not be subject to any federal antitrust scrutiny;

(5) A modified H-S-R would give the state a systematic way of reviewing mergers and takeovers that may be harmful to consumers before such transactions were consummated;

(6) If a statement of community impact was also required as part of a modified H-S-R filing, state officials might also be in a position to negotiate ways of cushioning adverse community impacts;

What Are the Disadvantages That Might Come From a Modified H-S-R Review?

(1) Depending on how the requirement for premerger disclosure is structured, some amount of additional resources, most likely in the Attorney General's Department would be necessary;

(2) If the time frames for review are modeled after the federal law, time will be tight for reviewing what are often complex transactions; under federal law, the initial review has to be completed in 30 days from the date the materials are filed by the merging parties (15 days for tender offers); requests for so-called "second request" letters, however, can extend the review period to about 2 months or even more, depending on when the government's request is complied with by the parties;

(3) Review under a traditional H-S-R procedure would not include review of potential harm to employees, communities, shareholders, or managers; review would be limited to injuries to consumers caused by a lessening of competition;

How Would a Modified H-S-R Operate at the State Level?

There are some practical problems involved in defining which merger or takeovers would be required to file disclosure statements with state authorities. It does not make sense merely to adopt the same triggers that operate at the federal level. For instance, under federal law, generally for mergers involving manufacturing firms, parties must file under H-S-R if the acquiring firm has $100 million in total assets or net sales and the acquired firm has $10 million in net sales, or for non-manufacturing firms, if the acquiring firm has $100 million in total assets or net sales and the acquired firm has $10 million in either sales or assets AND if the acquiring firm would end up holding 15% or more of securities or assets or in excess of $15 million of securities and assets.

While this trigger might be appropriate on a national level, its applicability to the much smaller, more local markets that would be present in a state analysis is not appropriate. At the state level, it may be better to institute a simple percentage of Massachusetts-based assets trigger.

For example, filing requirements at the state level could be framed as follows:

> Any merger or takeover that would result in the acquiring firm holding a certain percentage of Massachusetts-based assets (this would include Massachusetts-based corporations as well as out-of-state firms with operations in the state) would have to file with state authorities either their federal H-S-R disclosure statement, or if the parties for some reason are exempt from federal filing requirements, then a similar form, modified for state purposes. Attached to this memo is a copy of the H-S-R Notification and Report Form.

Another option is to make filing requirements more discretionary with state authorities. Parties to mergers or takeovers that meet the trigger level of asset control in the state would file a short notice with state authorities who would then decide in short order whether or not the parties had to file their federal H-S-R or modified state form with such authorities. This approach has the advantage of requiring complete filings only for those mergers or takeovers that pose competitive concerns.

Would State Filing Requirements Be Preempted By Federal Law?

No. It is well-established that in the field of antitrust, there is no federal preemption of state law even where the state law may affect interstate commerce, as long as the state law is supplementary to the federal regulatory scheme. This is an important principle to understand. In general, there is no federal preemption in this area. It is also important to keep in mind that a state disclosure requirement involves the production of documentary information to state authorities and does not authorize court action that would otherwise be outside the jurisdictional scope of state antitrust prosecutors. State civil subpoena powers, particularly in the antitrust area are already quite broad and extensive. Thus, disclosure requirements directed to firms that have even minimal contact with the Commonwealth, would be consistent with the extensive discovery powers already available.

2. EXPANDED STATE ANTITRUST POWERS IN MERGER AREA

Background:

Massachusetts does not have a law that mirrors section 7 of the Clayton Act by prohibiting anticompetitive mergers in their incipiency. (As noted in part 1 of this memo, however, state attorneys general can seek to enjoin anticompetitive mergers in federal court under the Clayton Act.) Although Massachusetts does have a state law that prohibits monopolies, the legal standard for condemning monopolies is much tougher than the standard under Section 7.

' There are a number of states, however, that do have mini-Section 7 acts, including Texas, Washington state, and New Jersey. In general the statutory language tracks section 7 and I have attached copies of each of these statutes. To my knowledge no state has a mini- or modified H-S-R disclosure requirement as described in part 1 of this memo. It would appear that the states with mini-Section 7 acts use their extensive pre-complaint civil subpoena powers to obtain information about proposed acquisitions.

What Are the Advantages To Having A State Section 7 Act?

(1) Perhaps the most practical benefit from having a state Section 7 act is that parties to a proposed acquisition that may pose competitive concerns in Massachusetts markets may be more willing to work something out with state authorities prior to the consummation of a merger or takeover.

(2) From a law enforcement and consumer protection perspective, a mini-Section 7 means that an attorney general can bring suit in either state or federal court,or file both a federal and pendant state claim in federal court. The advantage to this is that the penalties for the state claim could be framed to be different from the federal remedy, thus affording both the potential for greater relief for Massachusetts consumers and giving state authorities more leverage in negotiating acceptable resolutions to problematic mergers or takeovers.

What Are The Disadvantages To Having A Mini-Section 7?

(1) There would obviously be serious opposition to the enactment of either a state mini-Section 7 or a modified H-S-R from business and commercial interests.

(2) A state mini-Section 7 may be viewed by some as redundant and unnecessary since the state can already sue under federal law.

Would A mini-Section 7 Be Preempted by Federal Law?

For reasons already explained in part 1, the answer is no. It should be noted, however, that there is one case where federal authorities took affirmative action with respect to a merger by entering into a consent decree to resolve competitive concerns, and then a state tried to enjoin the merger in state court. In this instance, a California state appeals court stated that in view of the FTC consent decree in this case, the federal authorities had occupied the field. That case, involving Getty Oil, CCH 66858 (1988), is now on appeal to the California Supreme Court. This particular case is an anomoly because the usual circumstances where states get involved in merger litigation is when the federal agencies have remained silent and have merely permitted the H-S-R waiting period to expire without taking any action. Under this scenario, which is the usual course of events, states are not precluded from antitrust litigation merely because the federal agencies have raised no objections.

3. RECOMMENDATIONS FOR ACTION AT FEDERAL LEVEL: ANTITRUST

This memo contains a description of certain antitrust-related recommendations for action at the federal level. During the course of discussions before the Commission, the role of federal antitrust policy and enforcement as been a topic of concern. It has been pointed out that certain changes at the federal level could result in greater scrutiny of harmful mergers and provide some help to state authorities in examining mergers and takeovers that affect local markets. Those changes include: (1) Sharing of H-S-R or other pertinent information with state authorities; (2) increasing the time period within which the federal antitrust agencies must review tender offers; and (3) an increase in antitrust enforcement generally and a renewed commitment to federal merger policy as embodied in Section 7 of the Clayton Act.

(1) Greater Sharing of Information with the States

Background:

For the past four years, there has been a growing demand by state attorneys general for federal agencies to share H-S-R disclosure materials with the states. As discussed previously, prior to 1984, the Federal Trade Commission interpreted H-S-R to allow such information-sharing to facilitate the role of state officials in antitrust enforcement -- a role that historically has been recognized by statute. In 1984, however, the FTC reversed that policy and ruled that it was barred from sharing information with state officials. Subsequently, this interpretation has been upheld by federal circuit courts.

In 1986 and 1987, legislation was introduced to restore the discretion of federal officials to share H-S-R materials with states officials who undertook to maintain the confidentiality of such information and to use it only for law enforcement purposes. To date, no legislation has passed to accomplish this goal. As expected, the legislation has met stiff opposition from industry groups who argue that permitting states to share this information poses serious confidentiality concerns. At the Congressional hearings, however, there were no examples provided of any abuse by state attorneys general when H-S-R information was provided to them prior to 1984.

How Would the Sharing of H-S-R Information Work?

(i) Section 7A of the Clayton Act would be amended to permit the Justice Department's Antitrust Division or the Federal Trade Commission to provide companies' H-R-S filings to state attorneys generals for use in official antitrust investigations of mergers or takeovers that affect state markets;

(ii) The information acquired could be used only for law enforcement purposes by the state attorney general;

(iii) Guarantees of confidentiality would be required by the attorney general; and

(iv) The same sanctions currently applicable to Justice Department and FTC employees for unauthorized disclosure would be applicable to state attorneys general and their employees.

Another option that should be considered as a fallback position is to recommend federal legislation that would require the Antitrust Division and the FTC to notify state authorities when a company doing business in their state has filed under H-S-R. In some instances, states are not even aware that merging partners or corporate takeover companies have filed with federal authorities. If a state receives notice at the same time that the federal H-S-R waiting periods begin, a state will be in a better position to move expeditiously and, in appropriates cases, to serve civil investigative demands on the parties to a transaction to obtain relevant market share and other information.

What are the Advantages of Information Sharing?

The advantages to greater information sharing by federal antitrust authorities are fairly obvious: The state attorneys general are the primary enforcers of state antitrust law and in most cases they represent their states and consumers in litigation involving federal antitrust laws as well. Access to H-S-R information would enable states to move quickly to protect consumers by enjoining mergers or takeovers that may substantially lessen competition in relevant state markets.

What are the Disadvantages to Information Sharing?

From the state's perspective, the only disadvantages might be the need for more resources to review H-S-R materials pertinent to state markets. There is also the added responsibility and exposure from violating H-S-R confidentiality requirements.

(2) Extending Time periods for Review of Tender Offers and Mergers by Federal Agencies

Background:

Under current law, the federal antitrust agencies have 15 days to perform an initial review of cash tender offer. Additional time is permitted if the agencies issue a so-called second request letter. In general, the agencies have only 30 days to review even the most complex mergers, unless a second request letter is issued. It is widely believed that these time periods are much too short for complex mergers and takeovers.

Lengthening the Waiting Period

The commission could recommend that Congress amend H-S-R to lengthen the waiting period for mergers structured as cash tender offers from 15 days to 20 or 25 days. In addition, the Commission could recommend that federal antitrust agencies be given the authority to seek additional review time of 30 days from the courts to examine larger or more complex merger or takeovers.

These recommendations are consistent with provisions already introduced in Congress last year, but which did not pass.

(3) Increased Antitrust Enforcement

Background:

During the course of its deliberation, the Commission was presented with information showing a decrease in staffing at federal antitrust agencies of 40 percent and a five-fold decrease in challengers to mergers during the current administration. This reduction in federal antitrust enforcement has taken place during a dramatic and highly significant increase in merger and takeover activity throughout the country. The decrease, however, is consistent with the the merger policies of the current administration which has elevated oftentimes illusory gains in effeciencies over potential harm to consumer welfare from a decrease in competition.

Recommendation for Strengthened Enforcement Efforts and Adherence to the Policies Underlying the Antitrust Laws

As a general statement with respect to mergers and antitrust enforcement, the Commission could urge a return to the fundamental principles embodied in the Section 7 of the Clayton Act. The Commission could affirm its belief that undue concentrations of economic power are harmful to competition and consumer welfare and that Section 7 of the Clayton prohibits these transactions for those reasons. The Commission could urge that federal antitrust authorities commit to enforcing Section 7 by more carefully scrutinizing mergers that pose competitive concerns and by supporting legislation that would lengthen review periods.

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M E M O R A N D U M

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS AROUND THE REICH QUID PRO QUO PROPOSAL

GENERAL PROPOSAL:

Require a corporation to guarantee certain "soft-landing" benefits to employees, communities and other stakeholders dislocated as the result of takeover-related activities as a pre-condition of corporate eligibility for the protections offered by any form of Massachusetts anti-takeover statute. Such guarantees could include severance pay, continued health care coverage, bona fide effort to ensure union recognition by the buyer or roll-over of existing collective bargaining agreements, etc. The protections to the corporation could vary from those currently provided under M.G.L. c. 110C, 110D & 110E to whatever other protections may be recommended by the Commission.

BACKGROUND:

Professor Reich, in his presentation to the Commission, emphasized that even if the Commission found that takeovers maximize shareholder value and have a purely positive effect on the economy as a whole, which he doubted, it would still have to address three important questions:

1) How should we handle the dislocational/distributional costs across interests and geographical regions caused by takeover-related activities and what are the appropriate roles of the public and private sectors in this context;

2) What are appropriate/acceptable tradeoffs among the varied interests affected by takeover-related activities;

3) Should we require a quid pro quo from management if we adopt one or more proposals that offer greater protections to corporations based on their linkages to communities and the workforce and if so what are appropriate/acceptable quid pro quos.

Almost all the recommendations included in the briefing materials can be framed in terms of quids or quos in a Reich-type model. The proposals concerning business combination protections, clarification of corporate fiduciary duties, modifications to existing anti-takeover and antitrust laws can be viewed as "quos" since they are designed to protect corporations, their shareholders and stakeholders from coercive takeover activities. The other proposals in this package, dislocation chargebacks, severance and health benefits, real estate transfer bans, assumption of collective bargaining contracts, and pension protection, can be viewed as the "quids". The obvious challenge is to find the appropriate balances as posed by Professor Reich's questions to the Commission. However, there are two fundamental philosophical issues raised by the Reich proposal: 1) by definition, it creates a group of managers who will be held to standards of conduct not applicable to all their counterparts; and 2) the stakeholders, who are intended to be the primary beneficiaries of this proposal, will have the least to say in the corporate decision to adopt the "quids." A final concern relates to the resemblance in a number of ways of the Reich proposal to what is referred to as the European "penalty model" for dealing with industry and worker dislocation. This model which introduces substantial inflexibility into both labor and capital markets has be held to blame for the long-term underperformance of the European economy. While none of the proposals currently before the Commission go to this extreme, it is important in finding Professor Reich's appropriate balance to consider the impact of increasing numbers of "quids" on labor and capital mobility, particularly during a period of economic transition such as we are currently experiencing.

<u>RECOMMENDATION A</u>:

Link added management/corporate protections recommended by the Commission to comparable protections for stakeholders whether through business combination law for chargeback mechanisms or other combinations.

PROS:

Provides added benefits for majority of interests with relative balance between those of management and stakeholders.

CONS:

Raises equity concerns re differential treatment of dislocated stakeholders based on the cause of dislocation.

Could require significant investment in terms of administrative staff and budget to monitor/enforce adoption of "quids."

RECOMMENDATION B:

Amend Chapters 110C, 110D and 110E to require comparable benefits for stakeholders for continued management/corporate enjoyment of protections provided by current law.

PROS:

Provides added benefits for majority of interests with relative balance between those of management and stakeholders.

CONS:

Would require fundamental amendment of current laws to deprive parties of existing protections.

Could require significant investment in terms of administrative staff and budget to monitor/enforce adoption of "quids."

Would require added administrative investment to determine which parties decided to adopt the "quids" to enjoy continued protections and which choice not to avail themselves of these benefits.

The Commonwealth of Massachusetts
Executive Office of Economic Affairs
One Ashburton Place -- Room 2101
Boston, Ma. 02108

MICHAEL S. DUKAKIS
GOVERNOR
JOSEPH D. ALVIANI
SECRETARY

TELEPHONE:
(617) 727-8380

MEMORANDUM

TO: Commission members

FROM: Joseph D. Alviani
Paul J. Eustace

DATE: August 31, 1988

RE: POSSIBLE RECOMMENDATIONS FOR SCOTT'S ALTERNATE CHARTER

GENERAL PROPOSAL:

Provide Massachusetts firms with an alternate charter mechanism which, if selected, would require corporations to adopt corporate strategies and governance procedures designed to stimulate long-term investment in product, process and human resource development, employee participation, profit-sharing, performance-based compensation, expanded participation of outside directors and/or employee representatives on boards and other modifications assumed to lead to more effective and efficient management, increased productivity and a decreased probability that a firm would ever become a takeover target.

BACKGROUND:

The Scott proposal is a preventative approach designed to improve corporate productivity and performance based on the assumption that "good-performers" are less likely to become takeover targets. It is, therefore, designed to encourage corporate strategies and managerial styles presumed to promote competitiveness in order to obviate the need for direct regulation of takeovers. The proposal appears to be based on several assumptions: 1) an over-emphasis on short-term performance, principally financial, has caused firms to adopt strategies that do not promote their long-term competitiveness; 2) long-term investment in physical plant, product and process commercialization and human resource development are critical to long-term competitiveness; 3) employee commitment and participation in corporate decision-making increase productivity and improve performance; and 4) corporate governance provisions are significant determinants of management accountability.

Under the Scott proposal, a Massachusetts firm would have the option of organizing under an "Alternate Charter" with governance and organizational provisions designed to encourage human resource development, employee participation in and commitment to corporate decision-making and oversight by an independent board of directors. The "Alternate Charter" would provide Massachusetts businesses with another form of business entity to choose from in organizing themselves in the manner they feel best adapted to their goals and the nature of the competition they face. Firms that felt that the requirements of the "Alternate Charter" did not serve their interests would be under no obligation to adopt them. When a corporation opts for the "Alternate Charter" it must organize itself to include the following four basic components: 1) an incentive compensation plan available to all employees on the same terms; 2) an "employment and stabilization fund" managed by a committee representing employees, management and outside parties (could be experts or stakeholders) to invest in any legitimate business interest/opportunity that furthered the long-term interests of the corporation; 3) a corporate commitment of 2% per year of Massachusetts payroll for skills upgrading and/or retraining of Massachusetts employees; and 4) a board of directors with only one inside director who cannot serve as chair. The incentive compensation plan is designed to increase employee productivity and the commitment of both employer and employee to production quality and employment continuity. The "employment and stabilization fund" is designed to encourage a consultative decision-making process at all levels concerning the long-term goals and objectives of the firm and the strategies and investments required to make them a reality as well as to provide a mechanism for tapping the practical experience of employees on a day-to-day basis. The training commitment is designed to give employees access to the skills training and upgrading needed to ensure the highly skilled and flexible workforce essential to long-term competitiveness. The board structure is designed to encourage independent and professional management oversight.

The Scott proposal assumes that, although there is a growing consensus that the above components may be essential to long-term competitiveness, many managers might not be willing to adopt these methods absent certain incentives. In the original proposal, the basic incentives were in the form of state and/or federal tax deductions to the corporation for funds invested in the "employment and stabilization fund" and spent for training and skills upgrading. The original proposal also provided employees with an state income tax exemption for all income received pursuant to the incentive compensation plan. As a result of the deliberations of the Commission, the option of providing firms adopting the "Alternate Charter" with added protections from takeover has been raised. Although the main premise of the Scott proposal is that firms adopting these strategies would out-perform their competitors and, therefore, not need such added

protections, the idea of added anti-takeover protection was considered important as a means to further encourage long-term investments in light of the short-term pressures caused by takeovers.

RECOMMENDATION A:

Provide Massachusetts firms with an "Alternate Charter" option by amending M.G.L. c. 156B or enacting an new chapter relying exclusively on the tax incentives included in the original proposal to induce firms to adopt these strategies.

PROS:

Creates incentives for adopting corporate strategies assumed to increase productivity and long-run competitiveness which should benefit participating corporations, their workers, shareholders and local and regional economies and reduce the social costs associated with sudden economic dislocation whether or not takeover-related.

Voluntary nature of "Alternate Charter" should increase likelihood that firms selecting this option have made the commitment at all levels to effectively implement the structural and governance requirements of the "Alternate Charter" based on an evaluation of the benefits anticipated from changes in strategy plus tax incentives.

Could serve as an effective means to experiment with the effectiveness of these strategies in enhancing productivity and competitiveness and as a demonstration program.

CONS:

Raises issues about creating a self-defined and potentially substantial investment tax credit for firms adopting management strategies that, if the assumptions are correct, should be adopted in the corporate self-interest.

Assuming the "Alternate Charter" codifies the management strategies of the future, the end result could be to have the state and federal governments subsidizing what firms already want to do with removal of subsidies posing significant problems.

Empirically we do not really know what the short-term fiscal impact of this proposal might be, and, absent further research it would be difficult to set tax incentives that reflect the social benefits expected from the changes in corporate strategy.

RECOMMENDATION B:

Provide Massachusetts firms with an "Alternate Charter" option by amending M.G.L. c. 156B or enacting an new chapter making organization under the "Alternate Charter" a prerequisite for eligibility for added takeover protection through a business combination or other type of statute.

PROS:

Same as above re creation of incentives for enhanced productivity and competitiveness as well as experimentation.

CONS:

Same as above with added concern that by making protection from takeovers an inducement to adopting the "Alternate Charter" firms that would not necessarily adopt these strategies for purely economic reasons and, therefore, might not have the same commitment to their effective implementation might volunteer in order to gain added protections.

Compounds difficulties re setting appropriate levels for subsidy given the non-quantifiable value of added protection to firms that opt for the "Alternate Charter" to gain protection.

RECOMMENDATION C:

Create an exemption from a business combination type statute permitting an "interested shareholder" to avoid the business combination prohibition by adopting the "Alternate Charter" along the Connecticut model.

PROS:

Requires new management to commit to making a long-term investment in running the target in the form of cash set asides for the "trust" and training fund as a condition of avoiding a multi-year prohibition on business combinations.

Could deter under-financed and/of over-leveraged deals which would not be profitable if requirements for set-asides were met.

CONS:

Treats raider management differently than incumbent management by imposing certain management strategies on raiders which need not be adopted by incumbent management.

Imposition of strategies which require commitment and cooperation at all levels of the workforce may interfere with their effective implementation.

May require investments (set-asides) at a critical points of corporate change that would undo any benefits that could accrue through a takeover.

COMMISSION TO REVIEW MASSACHUSETTS
ANTI-TAKEOVER LAWS

ANNOTATED BIBLIOGRAPHY

Introduction

Since its first meeting on March 9, 1988 the Commission to Review Massachusetts Takeover Laws has been exposed to every facet of the national debate on takeovers. Polar views on the topic were expressed in expert testimony at working sessions of the Commission, as well as in literature distributed to the Commission, and in one public hearing that was held.

Each member of the Commission has received copies of the current Massachusetts takeover statutes, statutes from other states, and key literature in this area, and this bibliography will provide a short summary to indicate the types of written materials the Commission has received and considered.

INDEX

This bibliography is divided into the following sections:

I. Laws and Proposals

A. Massachusetts

1. Chapter 110C - Regulation of Takeover Bids in the Acquisition of Corporations:

Basically a disclosure statute of the "first generation" mode, but also contains the "penalty box" prohibition on tender offers for one year if an acquiror violates its provisions. That aspect of the law has been judged unconstitutional in at least two cases, but upheld in another. (The statute and its potential problems were extensively discussed in a memo from Secretary Alviani to Commission members, August 9, 1988).

2. Proposed Amendment to 110C - Act to Provide Severance Pay in the Event of Termination of Employment Following Takeover Bids.

A proposal to give workers terminated as a result of a takeover a lump sum payment of four times his (her) weekly salary for each completed year of service. Thus a twelve-year employee would receive a lump sum payment equal to one year's wages. Such severance contracts are common among higher level management (frequently referred to as "golden parachutes") and several companies have adopted similar plans covering a wider range of employees (referred to as "tin parachutes"). Golden parachutes frequently provide a lump sum payment equal to three years pay, often with little or no service prerequisites.

3. Chapter 110D - Regulation of Control Share Acquisitions.

This is an Indiana-type statute held to be constitutional in the 1987 CTS Supreme Court decision. It basically provides for a vote of shareholders to grant a controlling shareholder the right to vote control shares (e.g. more than 20% of the outstanding shares). Such statutes are generally considered effective in addressing one of the perceived abuses in takeovers, i.e. the coercion of shareholders, it does not address, and may aggravate, and other takeover abuses.

The Commission heard testimony that indicated that some Massachusetts companies have opted out of this statute because of its effect on these other perceived abuses. For example, the statute may make it easier to put a company in play by forcing a vote on whether to sell the company. Delaware considered such a statute and rejected for this, among other reasons.

4. Chapter 110E

Extends coverage of 110D to foreign corporations (non-Massachusetts chartered) meeting specified criteria that establish its importance and impact on Massachusetts shareholders, workers, and the Massachusetts economy. Its constitutionality has been questioned, but not resolved.

5. House No. 4741, and Senate No. 1502

Amendment to Section 65 of Chapter 156B of the General Laws clarifying the responsibilities of corporate directors, by specifying that a director may consider the interests of employees, customers, the economy of the state, and others, in deciding on takeovers, and may also consider that these interests may best be served by remaining an independent corporation.

The language of this amendment is similar to that of an Ohio statute, but Connecticut addressed the same concern by saying that directors "shall" consider those other interests rather than that they "may" consider them.

B. Other State Laws

1. Delaware - The Commission members heard testimony on Delaware's law, and while one witness felt the law offered too much protection for management, subsequent discussion argued that the law offered virtually no protection for management, per se. Any acquiror of more than 50% of a Delaware corporation's stock can replace the board and management and make any other changes he wishes to improve efficiency, including the selling of assets.

Delaware's statute is a business combination statute, similar in some respects to those of New York (the first of these statutes), New Jersey, Connecticut, and several other states, but by most accounts is considered less stringent than the other named statutes. The law addresses one specific perceived abuse in takeovers, the so-called junk bond bust-up takeover. It prevents the close-out of minority shareholders and certain business combinations with the acquiring shareholder.

The idea of the statute is to prevent acquirors taking on a lot of debt to take over a company, and once getting the requisite shares closing out minority shareholders, selling assets to pay back the debt, and keeping the remaining profits. The statute acts to protect non-tendering shareholders by enabling them to participate, pro rata, in any profits gained by sale of assets.

Layoffs often accompany highly leveraged takeovers and to the extent that these statutes lower the incentives for doing such takeovers, they lower the probability that workers will be so affected.

Delaware's freeze on business combinations last for three years, but the statute provides several ways for an acquiror to avoid being affected by it. If, for example, the acquiror is able to get 85% of the shares in the transaction, which makes him an interested shareholder (defined as a 15% shareowner), the statute does not apply. Early challenges to Delaware's law have been unsuccessful in having it enjoined, but no definitive ruling has yet been made.

Secretary Alviani also circulated a descriptive memo concerning Delaware's law to the Commission (dated August 8, 1988). The Commission also received data which showed how various trigger points and exception levels in a Delaware-type statute would have affected the approximately 160 successful hostile bids since 1982.

2. New York - New York's business combination statute (Section 912 of the New York Business Corporation Law) provides for a five year freeze on business combinations with the acquiror, and does not provide for a Delaware-like out if the acquiror gains a certain percentage of the shares. The trigger point for becoming an "interested shareholder" under the New York law is beneficial ownership of 20% of the shares.

3. New Jersey - Similar to New York's business combination statute, but more stringent in some ways, for example, it has a lower trigger for a person becoming an interested shareholder (10%).

4. California - A California Commission recommended minimal takeover related laws for California ("Corporate Takeovers: A Recommendation for a California Policy," by Senator Dan McCorquodale, Chairman of the California Senate Commission on Corporate Governance, Shareholders Rights and Securities Transactions). It also recommended Federal legislation requiring "minimal standards of conduct for corporations, bidders, and investors." John Pound, a member of California's commission appeared before the Massachusetts commission and expressed his opposition to state takeover statutes.

5. Connecticut - Connecticut also adopted a business combination statute similar in many respects to New York's (Connecticut has a 10% trigger for a person becoming an interested shareholder, however, while New York's is 20%), but it also has several significant differences.

First, it mandates that a director "shall consider, in determining what he reasonably believes to be in the best interest of the corporation, the long-term as well as the short-term interests of the corporation," and then lists several other areas for directors to consider, including the interests of employees, customers, suppliers, and creditors. The use of "shall" in this statute is significantly stronger language than that found in other statutes that say that directors "may" consider other interests.

Second, it establishes a Connecticut Partnership Compact, comprised of the commissioners of economic development and labor, ranking members of joint committees judiciary and labor and public employees, a representative from the Connecticut Business and Industry Association, and from the AFL-CIO, and six public members.

The law exempts from the 5-year freeze-out provision any acquiror who obtains board approval before becoming an interested shareholder, or corporations that on, or after, July 1, 1989 sign the Connecticut Partnership Compact.

II. Papers and Reports

1. Allen, Julius. "Corporate Takeovers: A Survey of Recent Developments and Issues." Congressional Research Service, August 6, 1987.

   This is a general, but comprehensive review of research and other literature on takeovers. The author concludes that while there is general agreement that short-term stock prices of target companies increase, "other effects of takeovers are a matter of widespread differences of opinion. In many cases, the evidence is insufficient to reach a sound judgment on such effects, especially the long-range economic effects." (From summary page, 1).

2. Chandler, Alfred D. Jr. Conclusion of "Scale and Scope: The Dynamics of Industrial Enterprise." Chapter XIV, "The Dynamics of Industrial Enterprise," Prepared for the Business History Seminar at Harvard's Graduate School of Business. February 1, 1988.

   The Commission was provided with this chapter, which is a broad look at key developments in the growth of American enterprise,and at causes of its decline in some areas. The author observes, starting on page 46, that "In the late 1970s an entirely new phenomenon appeared, the unfriendly takeover. The goal of such takeovers was more for financial gain than for systematic long-term restructuring of the acquired enterprise -

to profit from the sale of operating divisions, not to improve the performance either of the divisions or what remained of the acquired enterprise as a whole...In any case, the takeover of diversified companies rarely restored the operating divisions' competitive capabilities. It rarely led to an extensive investment in new facilities and the careful reestablishing of managerial skills."

3. Lipton, Martin. "Need for a Uniform State Takeover Law," New York, Law Journal. March 21, 1988, pp. 1-3.

In this article, a takeover lawyer reviews various types of takeover statutes, and explains the characteristics of control share statutes which can aggravate some takeover abuses, and that led to the development of business combination statutes. He further suggests a uniform state business combination statute that would be triggered at a 1% ownership level by an interested shareholder. Any such holder wishing to make an offer for the company would request a referendum of shareholders to vote on the offer, and that vote would have to be held within 120 days after the request. The statute would include a five-year bar to a squeeze-out merger if an acquiror violated the terms of the statute.

4. Margotta, Donald. "Distorting Corporate Investment," New York Times, September 27, 1987.

This article argues that while hostile takeovers may increase competition in financial markets, they can simultaneously diminish competitiveness in real product markets.

5. Matheson, John H. and Jon R. Norberg. "Hostile Share Acquisitions and Corporate Governance: A Framework For Evaluating Antitakeover Activities," University of Pittsburgh Law Review, Vol. 47, 1986, pp. 407-489.

These authors provide a suggested framework for analyzing corporate governance questions, but do not address takeover statutes, per se. They are generally critical of management actions to deter hostile acquisitions.

6. Pound, John. "State Legislation Restructuring Takeovers: An Economic Overview," Prepared for the California State Commission on Corporate Governance, Shareholder's Rights, and Securities Transactions. January, 1988.

This article is generally critical of individual state takeover legislation, and calls for "states to band together and press for creation of a broad-based, interstate legal or legislative solution."

7. Rosengren, Eric S. "State Restrictions of Hostile Takeovers," Forthcoming in Publius: The Journal of Federalism, August 1988.

Mr. Rosengren, who also testified at a Commission meeting, is critical of state takeover legislation, and argues in his article that although these laws are frequently labelled as shareholder protection devices, they instead, in his view, "increase the power of managers to prevent acquisitions; hence their primary beneficiary is incumbent management."

8. Scherer, F.M. "Corporate Takeovers: The Efficiency Arguments," Journal of Economic Perspectives, Vol.2, No. 1, Winter 1988, pp. 69-82.

This author concludes, based on data from the Federal Trade Commission's line of business data, that takeovers do not improve corporate efficiency, and that,

> If takeovers on average do little to improve corporations' operating efficiency, the objection to regulations emphasizing fairness and other criteria loses much of its force, and the case for slowing down what is clearly a costly and disruptive corporate restructuring process gains plausibility.

9. Scott, Bruce. "Creating an Alternative Form of Governance," June 22, 1988.

Professor Scott, who also testified at a Commission meeting, suggests an alternative form of corporate charter. Corporations would voluntarily adopt an alternative charter that might, among other things, require management to "undertake a limited form of power sharing with employees to increase both managerial effectiveness and employee commitment." Incentives to adoption of the charter would include tax benefits for the corporations and its employees, and a protected corporate fund to be used for capital investment.

10. "Can States Stop Corporate Takeovers?" from the Investor Responsibility Research Center. Copyright 1987.

This is a comprehensive report on the evolution of state takeover laws, and provides short descriptions of key state statutes and court decisions.

11. Winch, Kevin and Gary W. Shorter. "Corporate Mergers: A Look at the Record," Congressional Research Service, July 16, 1987.

This report provides extensive data on individual mergers from 1980 through 1986, but does not offer any conclusions on public policy implications:

"Again, there is more dispute than agreement. Some defend mergers as leading to a more efficient utilization of resources, enhancing economic growth through productivity gains and, in the long-run, creating employment opportunities. Others point to plant closings soon after merger completions, and identify lost jobs and shattered communities as the aftermath of mergers.

III. Original Proposals Considered by the Commission

1. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: Possible Recommendations re. 110C, 110D, 110E

This memo outlined for the Commission the strengths and weaknesses of the Commonwealth's current takeover laws. It further recommended, among other things, modifications to 110C that would strengthen it against constitutionality challenges (especially with regard to the "penalty box"), and proposed possible repeal of 110E in light of decisions in other states on similar statutes. Also proposed extending coverage to banks and other corporations not presently covered by the statute.

There was a related memo dated March 3, 1988 from Alviani/Eustace that was more descriptive in summarizing current Massachusetts takeover laws.

2. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: State Hart-Scott-Rodino and State Clayton Section 7 Acts

This memo provided arguments in favor of adopting state statutes mirroring to some extent their federal counterparts - the purpose of having possibly duplicate statutes is that information provided to federal authorities under federal laws is not necessarily available to state authorities on a timely basis.

3. Date: August 22, 1988
From: Barbara Anthony
RE: Antitrust-Related Recommendations for Takeover Commission Consideration

This memo provided more detail and background for the proposals and recommendations in the previous Alviani/Eustace memo on state versions of Hart-Scott-Rodino and Clayton Section 7 Acts.

4. Date: August 31, 1988
   From: Co-Chairs Alviani/Eustace
   RE: AFL-CIO Proposal for Severance/Continued Health Benefits and for Prohibition of Sales and Real Estate Following a Hostile Takeover

This proposal would limit the use of corporate real estate by a hostile acquiror to finance a takeover, and would provide a lump sum severance benefit of four weeks pay for each completed year of service to employees laid off within two years of a takeover.

5. Date: August 31, 1988
   From: Co-Chairs Alviani/Eustace
   RE: Recommendations Requiring Assumption of Collectively Bargained Contracts by Acquiring Corporations

This memo outlined the special conditions that put employees in a precarious position following a takeover, and one recommended option was to require purchasers to assume collective bargaining agreements.

6. Date: August 31, 1988
   From: Co-Chairs Alviani/Eustace
   RE: Possible Recommendations for Scott's Alternative Charter.

This memo outlined proposed recommendations related to several of Professor Scott's ideas on the alternative charter.

7. Date: August 31, 1988
   From: Co-Chairs Alviani/Eustace
   RE: Possible Recommendations Regarding Pension Protection Provisions

One recommended option was to endorse federal legislation that would prevent use of employee pension funds or surpluses for debt service, and if federal action is not taken, support state action.

8. Date: August 31, 1988
   From: Co-Chairs Alviani/Eustace
   RE: Possible Recommendations for a Dislocation Chargeback Mechanism

A proposal to charge back to the buyer costs caused by takeover related dislocation of employees, for example, costs related to employment and training programs, health care, and job counselling, among others.

9. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: Possible Recommendations around the Reich Quid Pro Proposal

This was a follow-up proposal subsequent to Prof. Reich's appearance before the Commission. This proposal would require corporations to provide specific guarantees (for example, severance pay, continued health care coverage, etc.) in order to receive the benefits of takeover protections.

10. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: Clarification of Fiduciary Duties - 1

This is a proposal to clarify the fiduciary duties of directors by amending M.G.L. c. 156B §65, to explicitly state that "...in determining what a director reasonably believes to be in the best interests of the corporation a director may consider the interests of the corporation's employees, suppliers ... shareholders, including the possibility that these interests may best be served by the continued independence of the corporation."

11. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: Possible Recommendation for Business Combination Legislation

This memo described the objectives and function of business combination statutes, and discussed merits of New York type freezes versus Delaware-type freezes with exceptions.

12. Date: August 31, 1988
From: Co-Chairs Alviani/Eustace
RE: Clarification of Fiduciary Duties - 2

This memo basically reiterated the recommendations made in the earlier August 31 memo, but specifically addressed some concerns raised by the Commission members. Those concerns were essentially withdrawn after further discussion of the proposal.

13. Date: September 28, 1988
From: Co-Chairs Alviani/Eustace
Re: Delaware Trigger and Ownership Thresholds and Prohibition Periods - Update

This memo reflected the consensus of the Commission to adopt a Delaware-type statute, with modified trigger and exception levels.

Part II

Testimony and Correspondence

Relating to the June 22, 1988 Commission Hearing

Table of Contents

*Written testimony was not available. Remarks were transcribed from a tape of the hearing.

Bruce Scott, Professor
Harvard Business School

Creating an Alternative Form of Governance

States charter firms, hence the states have an opportunity to offer alternatives to the present management/stockholder dominated formula. Some states have already enacted changes in response to local pressures to limit hostile takeovers and the threat of losing important corporate citizens. Unless such state laws require explicit changes in the governance process of the firm, however, they are likely to further entrench management and protect the all too familiar non-competitive performers.

States which wish to review their rules of incorporation should be encouraged to consider creating an "alternative" type of corporate charter; one type could reflect current practice and the second a choice by the firm to opt for a different process of governance. The choice should be up to the firm.

The alternative charters should aim to deal with the two problems noted above, the longstanding separation of ownership and management which has been aggravated by the more recent increase in turnover of shareholdings, and the growing separation between top management and operating management. The alternative charter might require that only one member of management could sit on the board, and that the chairman must be an outsider. It might also require that the chairman report at least once a year to stockholders on the broad questions concerning the value and use of their capital. In a sense

this would be a return to what was common practice in the 1950's, where the president of the firm typically was "CEO," and where the chairman reigned more than ruled. It probably would lead many companies to a two level governance structure; a board of outsiders chaired by an outsider and a management committee chaired by the CEO. This would correspond to the two tiered system found in Germany. It would be a simple structural change designed to limit management dominance of the board and hence to limit entrenchment. In return the alternative charter would allow boards to consider the interests of groups other than stockholders; i.e., bondholders, employees, communities, suppliers and customers.

The alternative charter might also require management to undertake a limited form of power sharing with employees as a way to increase both managerial effectiveness and employee commitment. It might also require incentives designed to encourage more equal distribution of incomes and the sharing of gains through performance.

Power sharing acknowledges the competence of employees, particularly first line management and those closest to the product or service ultimately delivered to the customer. By empowering such employees it would also help enlist their commitment to the firm and to the quality of products of services which it creates for its customers. More equal sharing of power should be accompanied by more equal sharing of income, and particularly income related to the performance of the firm.

To encourage the internal sharing of power, responsibility and incomes I suggest three key changes, a tax favored employment stabilization and development fund, a tax favored scheme for shared gains in performance, and a modified governance process for the fund. These changes, coupled with those affecting the board, should be a package deal; a company would have to accept the whole package to qualify for the alternative charter.

An employment stabilization and development fund would be way to encourage modest, evolutionary change in the internal governance process. Firms electing the alternative charter would establish such a fund and make contributions to it. The monies in the fund could be used for any bona fide business purpose approved by the trustees of the fund except the purchase of land. Each participating firm would thus have its own fund, and each fund would be administered by a board of trustees consisting of corporate officers, middle managers and operating employees of said firm. Each firm would decide on its own process for selecting trustees, subject to the proviso that no more than one third could be officers of the firm and no less than one third be non-exempt employees. Contributions to the fund would be voluntary, as in a deferred savings plan for an individual, and have a specified limit related to total payroll (e.g., 3% of payroll.) Contributions by the firm to the fund would be deducted from income in the year they were contributed, income accruing to the fund would be tax exempt, and decisions on when and how to spend the money would be at the discretion of the trustees of the fund.

To take advantage of the fund, the firm would have to invest the proceeds, i.e. purchase equipment or expand plant capacity. Normal operating

expenditures, including those for a company picnic, are tax deductible anyway, so no tax advantage would accrue if they were used for such purposes. However, an investment in capital equipment paid for from the fund would be fully expensed at the outset, a situation more generous than the investment tax credit. This tax advantage would be created as an incentive for a limited change in the governance process.

To use the proceeds for purchasing capital equipment rather than picnic supplies, management would have to persuade the trustees, meaning the employees, that the investment was in their best interests. The more effectively management and employees could work together on this board of trustees, the more management could usefully contribute to the fund, and the greater its tax savings. Companies able to develop a smoothly working trust fund would achieve a competitive advantage through tax savings on top of the advantages of improved communication within the firm and improved relations with employees.

It would be essential that such a program be voluntary: no firm should be forced to experiment with such a change in its governance process. However, if some firms did adopt the change they would achieve a competitive advantage and thus put pressure on others to consider a similar change. It is also important that contributions be related to payroll (within the state) and not to sales or earnings. Part of the idea is to promote the firm's commitment to stable or increasing employment, part is to create an advantage for those creating employment with a particular state.

A voluntary mechanism, working through the firm, has strong advantages over European regulations limiting layoffs as a way to curb the callous practices found in some US firms. Rigid procedures and/or high indemnities for layoffs, as in much of Europe, make for an inflexible labor market, and one where management thinks long and hard before adding extra employees. These rigid, punitive schemes are clearly one of the prime reasons why EEC firms have created almost no new jobs (net) since 1970 while US firms have created some 30 million non-agricultural jobs net.

In addition to the fund, an alternative charter might stipulate that firms must pay a performance related bonus to all regular employees and that all must receive the same percentage rate relative to base pay. Firms would determine their own bonus schemes: the charter would only require that they be related to performance, and hence that they go up and down with performance. In a good year, for example, all employees might receive a 10% bonus while in a poor year it might be 2% or even zero. Another firm with similar results might have higher or lower bonuses. The intent would be to promote solidarity of all levels within the firm on the one hand, and an end to industry wide pay equality on the other. At least some element of pay would be tied to the performance of the firm.

In return for a commitment by the firm to progress (and income) sharing, government might allow a portion (e.g., one third) of the bonus for each employee to be free of federal income tax. As an additional incentive for

income sharing, and hence more equal distribution, government might allow a higher fraction (e.g., two thirds) of all bonus monies to be tax free provided the firm had only a single bonus program, i.e., the one mandated under this program. Public policy would provide an incentive for firms to reduce inequalities of income, but each firm would make its own choice.

The premises would be (1) that society has an interest in greater equality of incomes, (2) that it is better to achieve that increased equality through the initial distribution, where it is tied to performance, than through taxation and redistribution, where it is not tied to performance and tends to distort economic incentives, (3) that public policy should support firms willing to tailor their compensation schemes to support public as well as private purposes, and (4) that participating firms could expect increased employee commitment, and hence contribution, thus serving their own interests while serving a public purpose.

While this scheme would no doubt have some direct impact on incomes and on performance, its primary effects might well be symbolic or psychological, and hence indirect. Compensation would be tied to performance for all employees; all would share in the ups and downs of their firm. Employees as well as the stockholders would have an immediate interest in the financial performance of the firm. Unions and union leadership would also have an interest in the performance of individual firms. Adversarial relations would negatively affect paychecks as well as profitability. Union locals would have to balance the interests of the firm with the grievances of particular constituents.

In time, US firms might shift the way they respond to economic downturns. While the traditional mode has been to cut costs by restricting or reducing employment in the face of both management and union resistance to pay reductions, this system would respond by automatic reductions in bonuses, hence in pay. As a result it might well lead toward a system where pay would adjust first, and employment second. Downturns would be shared broadly through paycuts rather than concentrating the sacrifices among those who lose their jobs. If this were to happen, it would also localize responsibility for the adjustment instead of thrusting it on the unemployment compensation system. Management and employees would take on increased responsibility, the government would have correspondingly less.

By encouraging a voluntary restructuring of corporate governance and likewise employee incomes, government could contribute to increased decentralization of the economic system. Public policy could do what it does best; it could promote the public interest through policy making. At the same time it could limit its direct interventions in the economy, thus not only reducing its own role but reinforcing the roles and responsibilities of firms, unions and individuals. In so doing it could contribute to increased recognition by Americans at all levels of the need for increased commitment to the achievement of excellence as a way to achieve increased incomes, and of increased equality in income as a way to achieve increased commitment and less intervention by government. The benefits of this consciousness raising, though intangible, might overshadow all the others.

MASSACHUSETTS TAKEOVER COMMISSION
ROBERT LEMIRE, LEGISLATIVE COORDINATOR, LL-1726 IAMAW
JUNE 22, 1988

Good morning ladies and gentlemen, I want to thank the Commission Chairs, Secretary Alviani and Secretary Eustace, and all the Commission members for providing this vitally important forum and the opportunity to testify before you this morning. Briefly, my background is in labor, I am active in local union activities and I am currently employed in the airline industry and have been so employed for the past twenty three years. I am 47 years old, married, and have four children. Up until roughly two years ago I had a career with the reasonable expectation that barring unforeseen social or economic upheavals I would enjoy a decent livelihood, the dignity in the work place that a "good job" engenders, and a fair retirement when the time came. That reasonable expectation, that dignity, and perhaps even that retirement no longer exist. The reason is called MERGER.

I believe the focus of this commission is on the hostile takeover type mergers, and the merger/buy-out that I am most familiar with, Texas Air/Eastern Airlines perhaps on the face does not appear to fit the hostile takeover criteria. After all the President and CEO of Eastern Airlines along with the Board of Directors welcomed Frank Lorenzo and his Texas Air group with open arms. Without straying too far into areas in which I have no direct knowledge, this buy-out which in actuality was a merger with several other airlines was done over the strong objection of the labor unions involved, and was on such shaky legal ground that each board member had to be indemnified for one million dollars before they would part with their yes vote. From the Board of Directors down this merger/buy out was an is extremely hostile.

I cannot speak to the business advantage of merger/buy outs, hostile or friendly. You have the Journal, Barrons, Business Week etc. that go over almost every facet of the various deals and arrangements, yes they tell you almost everything you could need or want to know about the proposed deal. What you will hear or read very little if anything about is what happens to the employees of the principal companies. The people who brought their talent, loyalty, and trust to the enterprise that in fact made it possible to be in the position to merge and improve if that be the case. Well if the companies are fair minded and long sighted they make proper provisions. They dovetail employee skills where possible, they retrain and reclassify, they provide retirement incentive packages that are attractive and fair, and finally for those employees that cannot be retrained assistance is provided in acquiring new employment. This scenario does exist, but it is the exception rather than the rule. Were it the rule there would be no need for this very important commission.

No, increasingly the rule is Lorenzo/Ichan et al Wild West corporate raider style. Play fast and loose with the rules, to hell with antitrust, to hell with contracts and agreements, and certainly to hell with employees, profit and greed being the alpha and omega. **3:00 Min.** I know time is at a premium therefore I will be brief in citing examples of extreme hardship caused by this acquisition/merger. The T/A management immediately set in motion the process whereby the assets of EAL were transferred to T/A insuring EAL could no longer be profitable. A meanspirited management team came on board to constantly harass EAL employees with the emphasis on contract people. In 1985

the year prior to Lorenzo's takeover EAL employed 38,000+ people there were 35 terminations for cause. The grievance backlog was under 800 cases. In 1986 the year of the merger/buy out there were 367 terminations the grievance backlog was over 1000 cases, in 1987 three were 303 terminations the grievance backlog was just under 2000 cases and so far this year 136 employees have been terminated, 2062 disciplinary days off have been awarded, and the grievance backlog stands at just over 3000 cases. Considering that the cost is any where from $1000 to $1500 per average arbitration case you can see the staggering economic impact of this policy on the union and the obvious intent of this management team. A new attendance control program was instituted that only the fittest could survive under. In Boston 50% of the mechanical workforce was laid off with no reduction in workload. A similar situation exists in the ramp service/cleaning/fueling areas of the operation. Naturally this causes large gaps in covering assigned tasks. These gaps are filled with forced overtime. Forced because employees who are tired or for various reasons cannot work beyond the eight hour shift refuse the extra work. Extra work that would not exist except for the cut back in numbers of employees. No excuse is accepted, one instance that stands out in my mind is that of a mechanic that explained to his supervisor that he could not stay over his shift that day because on the weekends his autistic child came home to be with the family. He worked the late night shift and his off time starts at 7:00 a.m. Over time this burden has affected his wife adversely and she was fearful of handling the child alone. After baring his soul to the supervisor he was told work or we will be talking about your future employment here.

This employee over twenty years has since left the employ of EAL long before retirement age. He could no longer stand the pressure. Last week at New Yorks LGA Airport 17 ramp service employees were sent home without pay for two days for refusing overtime. This is occurring all around the country as a result of this merger/take over. In the two years since the buy-out I have witnessed an entire workforce become demoralized.

Men retire with many productive years left rather than risk losing what retirement benefits they have accrued. Men leave the business rather than live under constant pressure. They leave rather than compromise their ethical standards pertaining to maintenance and repair. Remember every employee that can be fired or forced to leave is replaced by a lower paid person and no longer has to be delt with. Divorces are common, split households are also commonplace because of the constant harassment and pressure, the human toll is enormous. This corporate empire has accumulated a debt of over $5,000,000,000.00 That's right with a "B" billion more than many third world nations. The effect on this country if it were to collapse would be felt by every man, woman and child. This and may other similar situations would not exist if the laws presently on the books were adhered to.

In conclusion I ask this commission to consider a method whereby, in the case of any merger friendly or hostile the impact on employees, communities, states, and the nation be considered as a matter of law not as at present a mere courtesy. I would humbly suggest:

1. Employees laid off as a result of mergers and takeovers should receive similar consideration and benefits as those who lose

their jobs in massive layoffs and closings covered by the Massachusetts Mature Industries Act. The umbrella of notice, reemployment assistance benefits, and job placement assistance and training should be available to these employees as well.

2. Although not directly under state jurisdiction, I would hope that the Takeover Commission and the Dukakis Administration would recommend strong and improved enforcement of existing federal anti-trust laws which protect us all against unwarranted concentration in markets, and federal labor laws which protect employee rights on the job.

3. Finally, the rights and futures and must be a consideration in merger activity, and therefore, employees should be represented in the merger process. At very minimum a new owner should be required to recognize the employees duly elected representatives or bargaining agents to work out acceptable conditions of employment.

If this could be done no employee of any company would be able to tell the story I have just completed. Again thank you for your time and courtesy, and the opportunity to express my views this morning.

8 Min. 30 Sec. Total

MASSACHUSETTS/AFL-CIO

Voice of Organized Labor 400,000 Strong

June 22, 1988

TESTIMONY OF ARTHUR R. OSBORN
PRESIDENT, MASSACHUSETTS AFL/CIO
BEFORE
THE GOVERNOR'S SPECIAL COMMISION
ON CORPORATE TAKEOVER LAWS

Good morning. My name is Arthur Osborn. I am President of the Massachusetts AFL/CIO, representing over 400,000 working people and their families.

I appreciate the opportunity to testify before this Commission on an issue that has been a priority of Organized Labor for the last few years. My only regret is that we are here to "study" a bill to protect workers and communities instead of signing such a bill today.

In February of this year, the Massachusetts AFL/CIO testified before the Commerce and Labor Committee in support of two amendments to the state anti-takover bill. These amendments were designed to provide a safety net for employees of a targeted business. Our concerns remain the same today -- a requirement for severance pay to employees of a corporation involved and a provision that would prohibit the liquidation of real estate to either finance a hostile takeover or to ward off a raider.

These amendments are essential to any legislation dealing with takeovers in the Commonwealth. While we agree that shareholders interests should be safeguarded, Labor contends that investors' livelihoods are not the only ones at stake. It should be clear that employees with years of service invested as well as communities with jobs and neighborhoods at stake must be given serious consideration in any anti-takeover law.

MASSACHUSETTS / AFL-CIO
8 BEACON STREET • BOSTON, MA 02108 • TELEPHONE 617 / 227-8260

I urge the Commission to adopt these concepts in your study report for the protection of employees, shareholders and corporations.

These amendments do not make takeovers impossible. They only give targeted companies a chance to make decisions on the basis of their long term business strategies, rather than the knee jerk reactions of a frenzied stock market. Committed and responsible shareholders have as much as, if not more than, employees to gain from corporate decisions made with equilibrium and good business sense. With the adoption of the protections, the only ones who have a lot to lose are stock market sharks who miss out on the opportunity to turn into billionaires overnight, as always, at the expense of the employees of our corporations.

T. Boone Pickens and other corporate raiders have had their day -- it is time to join responsible corporate citizens, workers and communities to say No to quick profits over people and jobs.

LOCAL 1445 A.F.L.-C.I.O.

UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION

725 South Street ★ Boston, Massachusetts 02131 ★ 327-6000 - 6001 - 6002
JOHN PHINNEY, PRESIDENT PAUL DUFAULT, SECRETARY-TREASURER

July 14, 1988

Barbara Waters Ph.D., - J.D.
Assistant Secretary -Deputy General Counsel
Commonwealth of Massachusetts
Executive Office of Economic Affairs
1 Ashburton Place Room 2101
Boston, Ma. 02108

Dear Ms. Waters,

Attached is a copy of my remarks before the Committee regarding takeover legislation given at the Gardner Auditorium, State House, Boston, Ma. on June 15, 1988.

Thank you for giving me the opportunity to express my views.

Sincerely,

Eddie

Edward Holmes
Business Agent/Vice President

EH:rc

Enclosure

Mr. Chairman - Distinguished Panel Members

My name is Edward Holmes - I am a Business Agent/Vice President of Local 1445 - United Food & Commercial Union. I represent Filene's and Jordan Marsh employees in downtown Boston. Whether or not there is a need for some type of takeover legislation is not my decision to make.

I can only attempt to report to you my own personal observations and experiences with the Companies and the employees that I represent.

Briefly, in my own personal life, I worked for the B.F. Goodrich Company, (Hood Rubber Company) in Watertown for 23 years. In Christmas week of 1969, the plant closed, and I was out of a job. You don't know what trauma is unless you have had this experience. With a growing family of four children, it was like the end of the world had come. It is an experience that I hope none of you will have to go through. With limited skills but a willingness to work, I went to work at Filene's Distribution Center in Somerville.

I tell you this because there is a similiarity when a corporate raider takes over a company. Something is going to give. People are going to be hurt. Somebody has to pay for the cost of the takeover. A large debt has to be satisfied. The Jordan Marsh Company is a good example that we are currently aware of. Six hundred and seventy-five management employees were turned out - after years of devoted service.

Management people need job security
Non-union people need job security.
Our union members have the strength of our organization and our collective bargaining agreements offer protection, but they are not iron clad. So, every working person needs to

be protected from a system that borders on being criminal in its impact on the lives of working people and their families.

Filene's is another story of the trauma to its fullest that went on with Mr. Campeau's takeover of Federated Department Stores, Filene's and Filene's Basement. I can tell you first hand of the unrest and uncertainty that prevailed among the employees and management as well. It is at best undescribable, people asked, "What happens to our pensions? What happens to our medical coverage? What happens to our contract? What happens to our jobs?"

Mr. Chariman, I could continue but I would like to conclude with the request that something meaningful be done, to protect, most importantly, the people of the Commonwealth that you represent - protected against the greed of those people, who's least concern is the working person.

Thank you.

Tom Climo
Director
Amstar Workers Assistance Center*

Good morning, Chairman Alviani and members of the Commission. It is somewhat strange for me to be introduced as a director of a workers assistance center because that's only going back for about the last three months, and it has been an involvement for thirty-nine years with a company, I'm sure you're well aware of, that existed in South Boston. It was over in Charlestown, the Domino Sugar Company. I had thirty-nine years experience with that company, twenty-seven of those years as the Chief Executive Officer of the local union there. And having had the opportunity from my early employment with that company, to see that company grow. The American Sugar Company is the largest manufacturer of cane sugar in the world. They have five refineries east of the Mississippi, one in Boston, Brooklyn, Philadelphia, Baltimore and in New Orleans. And in the early 1950s, they began the refurbishing of all of those refineries that were at that time almost forty years old. And I became involved at the collective bargaining table and watched the attitude of that company, as they did very well, show at the negotiating table concerns that the employees had and were, if you will, were giving employees a fair share of the pie. They did so well that in the late 50's and the early 60's that they began to diversify. They changed the name of the company to the Amstar Corporation, and they went out and they bought three refineries on the West Coast, Spreckels Company, they refine beet sugar. They purchased Duff-Norton, a very profitable outfit that manufactures hydraulic lifts that you see around the airports; Milwaukie Tool, one of the major manufacturers of power tools in the world; and they got into some high tech. All the time, the employees were doing very, very well. The plants were modern and everything was going along fine.

Then in 1983, late 1983, the President of Simplicity Company managed to get enough stock to begin to engineer a leveraged - a hostile takeover of the company. As I'm sure you're all well aware, the chief executive officers of the company then became a little bit concerned because their positions are on the line because obviously, if there is he takes over, then all of their jobs are in jeopardy and they reach out to prevent that hostile takeover. They moved and formed a holding company, Amstar Holding, with the assistance of a great deal of money put up by Kohlberg, Kravis and Roberts, the notorious K K and R. And they borrowed some $481 million and leveraged that company to the hilt. And from that point on, from '84 to '88, it has been a horror story in these refineries. The immediate access to funds that are needed to pay back investment companies like K K and R, the immediate access to funding is employees. Three thousand people were laid off within a period of six to nine months across the country. What effect does that have on the worker? As far as I'm concerned, they begin to disregard all the commitments made in contract relative to merger of jobs. They begin to harass people to do work that they haven't been trained for. They begin to neglect the refineries because they have cut their work force back. The housekeeping goes down to a point where it is almost unsanitary. And, of course, right along with that, what was a very safe environment in which to work gets very, very unsafe, and if you'll

*Written testimony was not available. Remarks were transcribed from a tape of the hearing.

check the records with Amstar, you'll find the number of workman's compensation cases have increased dramatically in some three to four years because the place had just went to pot. Well, that went on for about two years and in 1986, and by the way, they had $1,300,000,000 in revenue, with something like $35 million in income, none of that geared back to the employees the way it had been in the past. The negotiating tables became an air of - what used to be an air of accommodation, it became an air of confrontation. It wasn't a matter of the employer then adopting a posture of, "Well, we have done very well. We have made a good dollar. You are going to get your share. The attitude across the table changed very dramatically because they are still looking for money to pay off these enormous debts and they are not going to have that money to give to the employee. So, what was normally an attitude, as I said, of accommodation, where they would turn around and say, "You've done well. It doesn't really matter these days that we've made millions and millions of dollars in profit. You're not going to get any of that. Not only that, you've got too much already and we want some back. Henceforth, two-tiered wage systems, give back, take always and no increase, and no improvement in what we had. All the time, multi-millions of dollars being paid off to K K and R. Some two and a half years later, after that company was formed, and Amstar was sold, it was sold again. This time, Merrill Lynch got in the picture and they put up $681 million, and that got rid of K K and R and now Merrill Lynch is in there, and they have to, again, satisfy Merrill Lynch. How do they do that? There is no more people to get rid of. They have turned around and sold off Spreckels. They sold off Duff-Norton. They got rid of the high tech. All these jobs lost, now reaching almost five thousand jobs. All of this to provide monies for the money brokers.

Subsequently, four years later, the trail of devastation in the sugar industry - it is unbelievable. Seven sugar refineries east of the Mississippi shut down in a period of six years. Amstar Corporation now exists with three refineries. Philadelphia is gone and Boston is gone as of March 18th. Spreckels is gone and as I said the other holdings are gone. I was in a conference last week in North Dakota of sugar workers, I hear again that the company is being sold. Only this time, it won't be sold as a group. It will be sold one refinery at a time, and then of course, just to look back, those of use who put that many years with this kind of a company and see what has happened. As people who are in a position to take over these companies, who have no, and in this case, no desire at all to invest in sugar refineries. They don't care about sugar. They look at sugar as white gold, to put the money in their pockets. So, on February 17th, they were notified that March 18th the refinery was shutting down here in Boston. And that was the newest cane sugar refinery in the world. There had not been one built for forty years prior to that refinery. It was over in Charlestown, highly automated, highly technical, with a very, very efficient work force. There isn't a refinery in the country that could compete with it, cost per pound, per employee. They shut it down for all the wrong reasons. February 17th they told the people that they were going to shut it down March 18th. Two days later they began the layoffs, no notification, no plant closing notice. The two months notice that President Reagan found, for whatever reason, to veto

the trade bill, because he wasn't happy with that, two months is nothing. You need six months or more. As you go through that and live it, you need that much time to prepare yourself for what is happening because you don't expect it with a company that was as solvent as Amstar Corporation. That is a multi-million, multi-corporation. They make multi-millions of dollars. They're still making a ton of money.

March 18th they shut the refinery down I became then involved with the workers assistance center. Four months prior to that, when the rumors began to circulate, I reached out to Paul Eustace, the Secretary of Labor, and to Arthur Osborne's office, to find out what was available in the state relative to plant closing notification, what was going to happen to all of these people that were going to be out of work in such a short period of time. With the assistance of Paul's office and then Arthur's office, I was then put in touch with the Industrial Services Program, and I met Janet Boguslaw and she was assigned the group. Efforts were made through Paul's office, through Arthur's office, through the city government, the state government to contact the corporate managers to find out what was going on and there was complete silence. And that is devastating because at that point, you know if they are not denying it, you know your place is going to go down. Everybody on the job, their whole life changes. Their eyes, they have a funny look in their eyes because they know they are going to be out of work. And these are jobs that weren't paying $6 and $7 an hour. These were jobs that were paying $11, $12, $13 and up to $17 an hour for the people who unloaded the shifts. We finally shut down on March 18th, and with the assistance of Paul Eustace's office, the Industrial Services Program, and the fact that we were able to negotiate $100,000 from the company, which is a mere pittance, to set up a center to begin to service these people who are now out of work, out of work with skills that are not marketable. Sure, some of the maintenance people, the electricians and the pipe fitters, they can find work. But the majority of people that refine sugar who are out of work, it became necessary, through the center, to begin to evaluate and assess these people, and get them in the pipeline so they could get retrained and look at other careers. And it is not easy, because the jobs that are out there, in these new careers have starting wages of $7-$8 an hour. That is devastating for a guy who has been making $12-$13 an hour for a matter of fifteen or twenty years. That is his lifestyle. All of a sudden he's just knocked down to almost nothing. I don't know what we would have done had not the Industrial Services Program set up the center and made it available for the two hundred fifty-five people from this refinery at lest to have someplace where they could go and feel that someone was out there caring about them, that they were not just going to be cast aside and put in the large bureaucratic state system of unemployment and what goes along with it. Not that they don't do a good job, but what is done at these centers is something that can't be done at any state level. The center provides a very necessary service. The people coming into these centers can sit down and see a friendly face like myself or peer counselors that they've taken out of the union. They come in there and they begin to assess what is happening to them.

What can be done to alleviate that? I don't know. I don't have the answers as to how you can stop LBOs and what has happened, the devastation. I do know this, that a company like Amstar, who had millions, who has millions of dollars should not have been able to escape their liability, which is put on the state and the city governments to retrain and take care of these people. Those companies should be made to pay. They have the money. There is a piece of property sitting over there on Medford Street in Charlestown. I don't know what it's worth, maybe twenty, thirty million dollars it will be sold for. Where is that money going? It's going to go to Merrill Lynch. It's not going to go to the employees. It's not going to help them pay for their expenses for retraining, for reassessing their careers. My involvement at this point is to serve those people. I feel, that I'm very, very pleased that I've had the opportunity to continue my service as representing these people and serving them as I did this as a union rep, and now through the workers assistance center. Again, I just think that it's a crime that the companies that have the money, that do what they do for money reasons only, without regard for the employees and the devastation that they leave behind. There ought to be something in the state laws which requires them to pick up more of the financial liability that is put on the state. Thank you.

Jamie Heard
Formerly of United Shareholders of America*

Thank you very much, Mr. Alviani and members of the Commission. I want to make it clear at the outset that I am testifying as an individual today and not on behalf of any organization. I formerly served as the executive director of the United Shareholders Association, which is a shareholder advocacy organization. I am no longer with the United Shareholders Association. I also for a period of about ten years was with the Investor Responsibility Research Center in Washington, D.C. Paul Quirk is currently a board member of the IRRC, and the IRRC provides research and analysis to institutional investors on corporate governance and corporate social responsibility issues. I'm an Adjunct Professor at Georgetown University Business School in Washington and I have taught courses there on social responsibilities of business since 1981. I'm also a member of the advisory council of the Calvert Social Investment Fund, which is the largest stock mutual fund in the country using social criteria to screen investments.

I want to cover about four topics today. I do have a statement which I'll submit for the record, but I'm not going to read the whole thing. And let me tell you what I want to touch on. I want to talk a bit about state takeover laws, what their purpose is, in my opinion, and what their effects are. I want to talk about the role that takeovers play in the economy. I want to talk about the role that institutional investors are playing in the corporate governance arena today. And I want to talk about takeovers and jobs, about which you have heard quite a bit already today. And then I want to spend a little bit of time talking about what I think that this Commission could productively do in terms of recommendations.

First let me start off by taking a few minutes to give you my views on state takeover laws. There are now more than thirty states that have enacted some form of state takeover laws and Massachusetts, as you know, is among them. The most important state to adopt a takeover law was Delaware, is Delaware. Delaware, as Professor Margotta knows, because he and I were both there, enacted what is called an asset freeze statute in January of this year. And a total of eighteen states, also including New York, New Jersey and Pennsylvania, have now adopted some form of asset freeze statute. Twenty states, by my most recent count, have adopted what are called control share acquisition laws modelled on Indiana's, and Massachusetts is among the states to have adopted such a statute. Justice Scalia observed in the Supreme Court's CTS case in 1987 that "a law may be both constitutional and economic folly. And this would be the case with state takeover laws." The principal purpose and effect of these laws is to transfer from shareholders to management the power to decide who will manage the corporation. In the case of control share acquisition statutes, this is accomplished by disenfranchising acquiring shareholders whose efforts to take control are opposed by target company managements. In the case of asset freeze statutes, acquisitions that are opposed by target company managements are thwarted by making it extremely difficult, if not impossible, to merge, restructure or sell the assets of a target company for a period of three to five years.

*Written testimony was not available. Remarks were transcribed from a tape of the hearing.

Now, it is sometimes said that these state takeover laws protect shareholders, but I think the available empirical evidence suggests that is not the case. There has been extensive research done by the Securities and Exchange Commission, the President's Council of Economic Advisors, and many independent academics. And the estimate of much of this research is that takeover laws cost the shareholders money. The estimates vary, but it is in the billions of dollars.

Other doubts about the benefits to shareholders arise from looking at how the laws get enacted. In Delaware, for example, where I testified, and spent about a month working in opposition to the legislation that was originally acted, there were no shareholders who testified in favor of the legislation. In fact, all of the shareholders who testified on the legislation, testified against it, and that includes individual shareholders, it included the United Shareholders Association, for which I worked at the time. It included pension funds, such as the California Retirement System, which testified through Mr. Robert Monks, who is known to some of you as the - Bob is the head of a group called Institutional Shareholder Services in Washington, D.C. The State of Delaware Retirement System, as a matter of fact, the chairman of the board, and the chairman of the finance committee of the State of Delaware Retirement System, who are political appointees of the governor, testified against the Delaware law on the grounds that it would be harmful to the interests of participants in the state retirement system. And that was done, I can assure you, over great political - it was great political pressure that was applied to the chairman and to the chairman of the finance committee not to testify. They testified as individuals, rather than on behalf of the retirement system, but they were there putting their names and their reputation on the line to advise the legislature in Delaware that this proposed legislation would be harmful.

A few words about the economic benefits of takeovers and restructurings. I know you've heard from a lot of economists, and I know you have a number of economists on your panel who are familiar with the literature on takeovers, but let me just throw out a could of numbers for you. SEC Commissioner Joe Grunfest, who estimated in a paper last year that the benefits to shareholders involved in takeovers, he estimated in a recent five year period was about $150 billion. Harvard Professor Michael Jensen, using a somewhat longer time period and less conservative assumptions, put the figure in the neighborhood of $400 billion. Now, what does this say? Well, in some people's view, it simply say that a lot of sharp people are making money at somebody's expense, but I think that if you look at the economic literature, I think the weight of it would tell you that takeovers, and the restructurings that flow from takeovers are creating, as Professor Jensen said in a recent paper, "are creating large benefits for shareholders and for the economy as a whole by loosening control over vast amounts of resources and enabling them to move more quickly to their highest value use. The phenomenon of takeovers has in fact led hundreds of companies to restructure their operations in recent years and in many instances companies have divested themselves of assets that had been poorly managed. The transfer of these assets to new ownership provides opportunity for more efficient use of these assets. Now that is not to say

that every takeover or every restructuring is a good idea or that every one is successful, because obviously that is not the case. But in the aggregate, I think that the evidence suggests, to me anyway, that these transactions are beneficial to the economy.

In my opinion, the wide spread enactment of state takeover laws not only threatens to halt this economically beneficial activity, but it also could encourage a new round of wasteful conglomerate diversifications. Take Delaware, for example. The Delaware statute, in effect, gives large, well-heeled corporations an advantage over acquirors who need access to the assets of a company in order to obtain financing. What does that mean? Well, the one thing it means is that the kinds of restructuring transactions that we have seen in recent years are disadvantaged under the Delaware statute, whereas a very large company, with lots of cash in the bank, billions of dollars in a case like, in a company like Kodak, for example, is in a position to make acquisitions, which in many cases are not going to be good deals. They are going to be conglomerate diversifications. And there is a lot of irony here because a lot of what the takeover and restructuring movement of the 80's did, in my opinion, was to unwind mistakes of an earlier era, the conglomerate diversification of mergers that we saw in the 60's and the early 70's. And I think that it is highly ironic that we now have created public policy, at least in the State of Delaware and in the other states too, which could lead to our restarting down that path.

There are some other statements, or other observations that I have about takeovers and the literature on takeovers in my statement, and I'll just quickly summarize them. There is a lot said, for example, about the fact that takeovers force companies to manage for the short-term and ignore the long-term, cut back on R&D, to prop up short-term earnings. Again, the empirical work that I've seen done by the Securities and Exchange Commission and the recent paper by Stanford University's Brownwyn Hall, finds no basis in fact for those charges. Not to say that it doesn't happen, individually on an anecdotal basis in some instances, but when one tries to look systematically at the evidence, the evidence just doesn't seem to be there. So, in a nutshell, I guess, those are my views about takeovers, and the benefits of takeovers and what I view as the harm that state takeover legislation is - threatens economically.

Let me say a few words about institutional investors and then I'd like to talk about jobs. Although it may not be the focus of the Commission's current inquiry, the role that institutional investors are playing as shareholders in today's market is something that I think you ought to be aware of and reflect on. Institutional investors are playing a much more active role in corporate governance today than in the past, but their role is often misunderstood. Not all institutions are short-term, quick buck artists. There are a number of institutions that are involved in corporate governance and shareholder rights issues today in a very serious way. These tend to be large institutions, public pension funds in particular, the College Retirement Equities Fund, which is the largest private pension fund in the country. Institutions such as those that belong to the Council of Institutional Investors, which Paul

Quirk is affiliated with. If you ask these institutions, and I have asked many of them, "How long do you hold your stock, on average?" They will tell you five, six, seven, eight years, longer in some cases. By anybody's definition, these institutions are long-term holders, not short-term players. Some of these institutions, and I think you've read about them quite a bit in the paper this year, have become quite active in asserting shareholders' rights, attempting to stop greenmail, for example, at companies like Gillette, attempting to persuade companies to submit poison pill takeover defenses to shareholders for their ratification. They've become very active, as Mr. Tierney, I'm sure knows better than almost any of us, in some of the hotly contested proxy fights this year. Now these institutions, in my view, are playing a very positive role as shareholders. They are asserting the prerogatives of ownership which have lain dormant for too long in our economy. And part of the mess that we are in, and Professor Scott I think talked a little bit about this earlier in terms of management of our companies in this economy - part of the mess we're in, in my opinion, is due to the fact that management isn't accountable to anybody. The board of directors certainly isn't representative of the shareholders or anybody else, in many instances, except for the top management. And to the extent that we have large institutional investors that are willing to play an active role in governance, in making management accountable for its performance, I think that's a very positive development and one that deserves support.

Let me now turn to jobs. Fear over job loss is clearly one of the most compelling concerns before this Commission and it is clearly the most powerful argument that has been used to support the enactment of state takeover laws. The fact that employees have suffered job losses due to takeovers in some highly publicized instances is often used to support arguments that enactment of state takeover legislation will save jobs. This is almost certainly not the case that in the aggregate over the long-term. Studies by the Labor Department and General Accounting Office establish that most job loss due to plant closings has nothing to do with corporate takeovers. This conclusion is also supported by academic research conducted by University of Michigan Professor Charles Brown and Harvard Professor James Medoff. In fact, they found that wages and employment generally grow faster following acquisitions. And in a study of takeovers in the state of New Jersey, Professor Glen Yago found no evidence that changes in ownership affect aggregate levels of employment, and he could find only about 2% of the job loss in the state that was in any way due to change in ownership. Indeed, I believe that to the extent that takeovers and restructurings result in more efficient use of economic resources, it can be expected that takeovers will create more jobs, not every takeover, but again, in the aggregate, I believe they will create more jobs.

I hope what does not escape your attention, that some of those who argue in favor of state takeover legislation to protect jobs are among the strongest opponents of federal legislation to provide plant closing notification to employees in affected communities. I also hope that you realize that state takeover laws provide no job protection to rank and file employees. There is nothing in the control share acquisition laws or the asset freeze laws adopted

to date that prevents the managements of companies involved from closing plants or laying off employees. Indeed, some legislatures have been treated to a rude surprise when companies that have received protection through the enactment of state takeover laws have restructured or gone private, in the process reducing employment.

Concern about the employment effects and the community impact of plant closings and plant relocations is a legitimate concern. I want to underscore that. I don't want people on this commission to think that I regard this as a non-issue. I don't. I think that it's an important issue. I believe, though, that there are a number of other effective ways to deal with these problems rather than enacting state takeover legislation. And let me briefly mention a couple of them. Notification of proposed reductions, i.e. plant closing notification legislation, would be one. Collective bargaining between individual companies and represented workers, and I think we are seeing some of that in some industries today, that would be a second. Third, employee stock ownership plans that give employees an effective voice in corporate policy. Another one was mentioned by Professor Scott earlier today, employee representation on boards of directors. And another one I'd like to mention is public policy requirements for successor owners that provide specified rights to employees affected by plant closings and restructurings. Now, what do I mean by this last item? I think what I mean, and I'm not a labor lawyer, and I'd defer to anybody who is, but I have talked to a number of people in the labor movement about this issue, including representatives of unions whose workers have been affected by takeovers. Successorship of contract is a term that I keep hearing and it means different things to different people, but in essence what it means is employees who are represented by a union, who have collective bargaining rights, often lose those rights, and often lose the right to be represented, as a result of a restructuring transaction, be it a hostile takeover or some other kind of restructuring. And the basic idea here is through legislation, either at the state or the federal level to provide some statutory protection for representative workers with respect to successorship owners. I believe those are better ways to deal with the employment problem than monkeying around with state takeover laws. Efforts to protect employees in affected communities by preventing takeovers are, I believe, misguided, and likely to prove counterproductive. Such efforts are targetted at a small percentage of employees in communities that are affected by relocations and restructurings. Moreover, to the extent that state takeover legislation prevents the efficient use of economic resources, it can only prove harmful to employment over the long-term.

OK, what should be done? Well, I don't have any hard and fast solutions here, but let me just throw out a couple of ideas. Corporate takeovers, related restructurings and the effects of these transactions are national in scope. Efforts to deal with these issues on a state-by-state basis, particularly in a state like Massachusetts, which doesn't charter very many large corporations, are not likely to produce sound public policy. State efforts to stop takeovers will prove harmful to shareholders and to the economy as a whole. They are unlikely to protect either employees or communities from the real

problems associated with economic change. Efforts to regulate tender offers should be centered at the federal level. The Williams Act, adopted in 1968, regulates tender offers at the national level. The Williams Act is designed to protect shareholders from unfair tender offer tactics and to provide shareholders with the necessary time and information to consider tender offers. Unlike state legislation, which is intended to create impediments to unsolicited takeover bids, the Williams Act is intended to be neutral, as between bidders and targets in a tender offer. Efforts to provide economic adjustment assistance to employees in affected communities can also be addressed legislatively at either the state or federal level, but it should be separate from corporate and securities law. Federal legislation should be either preempt state takeover laws altogether or set minimum federal standards for state legislation. Regulating internal corporate affairs should remain a state function. In other words, I am not suggesting that the federal government get in the business of chartering corporations or that it displace states from their traditional role of chartering corporations. Rather, I am suggesting that the Williams Act be extended to preempt state tender offer legislation or to set a floor for such state legislation.

As you deliberate, I urge you to consider the approach that California's Commission on Corporate Governance, Shareholder Rights and Securities Transactions adopted earlier this year. I have a lot of copies of this report. It is not very long. It is about eight pages long and I'll be happy to provide copies to the Commission. After careful study and review, this expert body of state government officials and outside advisors recommended federal preemption of state takeover laws. It recommended against the adoption of a California state takeover law. California has no state takeover law and in the view of this commission it should not engage in what has been called a race to the bottom with Delaware, in order to try and out-Delaware Delaware. The Commission was careful to limit its recommendation on federal preemption to takeover activities and not infringe upon the appropriate state interests of corporate governance and internal affairs. The Commission also recommended that problems often associated with takeovers, such as plant closings, or depletion of assets and resources should be resolved as separate issues. The California Commission recognized that California currently has jurisdiction over few of its major companies, most of which have decided to charter in Delaware. In fact, although Delaware bills itself as the sixth largest economy in the world, of the Fortune 500 companies, only three are chartered in the state of California. Rather than engage in a race to - when I pointed that number out to the Commission, they were shocked, but it is true. It may be down to two, as a matter of fact. Rather than engage in a race to the bottom, which it could not and would not wish to win, the Commission, the California Commission, recommended that California support federal minimum standard legislation that would set a floor beneath state regulation. Minimum federal standards would leave each state free to decide an appropriate standard for governance of corporations, with a certainty that Delaware or some other state would not continue the downward spiral of shareholder rights. Thank you very much.

Speech Presented To:

Commission To Review Massachusetts
Anti - Takeover Laws

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Paul E. Tierney, Jr.

June 22, 1988

Hostile Takeovers - An Active Investor's Viewpoint

It is my intention to make a few balanced comments concerning the economic and social effects of unsolicited offers to purchase publicly held corporations. While I am generally familiar with pertinent federal tax and securities laws and state takeover statutes, I am not a lawyer nor an economist. I speak as a business man who has been an active participant in the merger and acquisition world as a General Partner of Coniston Partners and before that as an investment banker with two major firms. The current political environment at the state level is of concern to me because it reflects a growing skepticism about takeovers, a suspicion that they constitute some form of illusory wealth creation for intermediaries and interlopers while other constituencies of corporate America are disadvantaged and deceived.

My experience and reflections on the takeover activities of recent years lead me to conclude that the acquisition process is sometimes painful but ultimately positive. One must ask the question, of course; who receives the pain and for whom is the process so positive? The relevant constituencies of the process can be divided into two broad categories. One is the immediate stakeholder interests of the acquisition target; the stockholders, management and labor. The other is the broader community within which the enterprise functions; the local and national economy.

On a micro-economic level it is hardly worth re-analysing the gains which have been experienced by shareholders who have been able to receive premium bids for their shares of takeover targets. Those gains have then been re-invested in other corporate assets, some of which may have been other under-valued securities. There can be little doubt that from a pure shareholder

perspective a free market approach to takeovers and a high level of activity in hostile bids and leveraged buy-outs has been extraordinary remunerative. The expected continuance of such activity has also contributed to broad support of price levels of publicly traded shares of U.S. companies.

The effects of hostile bids on management and labor are more difficult to summarize. My experience is that the process is generally favorable in the long run, but disquieting in the short term, especially on the very top management and on some of the less productive managerial support functions which have been allowed to perpetuate. These managers are often covered under golden parachutes or other severance agreements which more than compensate for their release from unproductive positions in uncompetitive corporate structures. My greatest concern from an ethical standpoint is the potential for partial dislocation of a company's work force following a takeover. As I will explain, our own experience at Coniston has been limited to acquisitions and restructurings which resulted in corporate entities with greater growth potential and enlarged employees bases. However, the merger movement as a whole is partly a process of consolidation and cost reduction.

It is a process whereby one buyer pays a premium for the right to control and manage another corporation. That buyer pays such a control premium because he believes he can better manage those assets and make them generate more profit. This will sometimes require a cut in the labor force, a reduction of pay-rates or a change in work rules. While these changes really occur in response to an ongoing competitive economic environment, they can be accelerated by the event of a takeover. People who give their labor and their commitment to corporate entities have a right to expect stability as long as

their corporation can compete effectively. I believe it a very proper role of both the state and federal governments to (a) create an economic environment in which corporations are encouraged to be competitive (b) prohibit the entrenchment of boards of directors and top management and (c) ease the pain of dislocated workers through transitional re-training, unemployment compensation and other creative means.

With respect to the societal benefits of takeovers, I believe that the functioning of the free market in this current phase of our national economic restructuring is making corporate America more competitive. Generally speaking, the battle for control of target companies is a battle to take underperforming assets out of the hands of marginal managers and redeploy them more productively through the auspices of a new owner.

The best defense, indeed the only proper defense, against a takeover, is a managerial strategy which maximizes shareholder value by keeping profits up and share process reflecting such performance. In the process of maximizing shareholder wealth, management creates benefits for the economy as a whole.

In a recent study by McKinsey & Co, the consulting firm concluded; "Skills are relevant only to a specific situation, and situations change constantly. Today there is a new set of questions for corporate management. They no longer should ask, is the portfolio balanced, are we diversified, how much dividends do our competitors pay, how fast will per share earnings grow? The right questions today are, what value do we create and where, are we the best

owner, do business units have the right size and scope, are management incentives consistent with our goals, and is our financial structure consistent with business objectives? None of this requires legislation or a poison pill."

When the forgoing questions are not asked or properly addressed by management, then the market place eventually forces such attention. Investors like ourselves begin to see a pool of untapped value. We identify underperforming corporations with strong franchises which have grown fat and which present opportunities for improvement. These opportunities are both for improvement of shareholders value and for improvement of the operating base of the corporation through the effectuation of some sort of basic restructuring, sometimes involving a sale of control and usually requiring new strategic thinking at the very top level of the corporation.

Our two most recent strategic block investments have been large public companies. Perhaps a summary of those investments will illustrate my point. The first case is that of Allegis Corporation.

Allegis, as most of you know, was the parent company to United Airlines, Hilton International, Hertz Corporation, Westin Hotels and Covia (the Apollo reservation system). For many years, under the leadership of CEO Richard Ferris, Allegis has pursued a strategy which was described as building an integrated travel company. The basic idea was to acquire businesses deemed complementary to United Airlines, such as hotels and rental cars, and attempt to integrate the customer flow of the various units with one another.

We had been familiar with Allegis from previous transportation investment activities and had been somewhat skeptical of both the concept and execution of the espoused strategy. However, our primary starting point as investors is a value analysis to determine whether or not to own a stock. In March, 1987 Allegis stock was selling in the mid 50's and our analysis showed that the after-tax value of its various components was comfortably in the range of $90 - $100. We believed that the company's strategy was not working to maximize shareholder value. Repeated equity offerings to finance expansion were constantly diluting shareholder equity and enraging institutional holders. An attempt to further entrench management was allowed by the Allegis Board when an ill-fated re-financing program was announced with a sweetheart placement of convertible debt to the Boeing Company.

The Boeing note was hurriedly concocted as part of the financing for a large airplane order. It gave over to Boeing an extraordinary number of rights to restrict Allegis corporate action through a set of positive and negative covenants. It also gave Boeing the right to convert into approximately 15% of the common shares of Allegis at a very generous formula price. The financing appeared to be a direct assault on shareholder value for the sole purpose of protecting existing management. Shortly after accumulating 13% of the Allegis stock and filing our 13-D report with the SEC, we commenced a consent solicitation to unseat the Board of Directors.

The costs of pursuing such a project are quite substantial. In addition to the seven day a week effort by our entire office, we also required the assistance of four law firms, a proxy solicitor, an investment bank, a dissident slate of outside directors and a host of other sub-contractors.

After filing and clearing proxy solicitation materials with the SEC we were organized to reach and talk to every shareholder. However, the general reaction to our proposal to change the strategy away from captive integrated travel was so positive that the Board of Directors decided to reverse themselves and abandon the basic operating strategy and their own recapitalization plan.

On June 9, the board met and accepted the resignation of CEO Richard Ferris. CFO John Cowan's resignation came shortly thereafter. First Boston was appointed financial advisor to help the company execute the divestiture and recapitalization plan which is now completed. Shareholders have reaped enormous benefits and United Airlines is once again a strong, independent company.

Now that we have successfully concluded the Allegis restructuring, a proper question is whether this whole exercise has been beneficial to shareholders in the short term but harmful to the underlying business or the other constitutencies of Allegis, principally the employees and customers. Does the general threat of proxy contests or other outside actions available to investors, cause management to give up on valid long term plans? I do not think so. My belief is that it merely requires management to become accountable, to become more practical. There are numerous examples of companies with ambitious long-term goals which are accepted by the market place and are highly valued. Scientific, organizational and service development can and should be embraced in long-term plans, but they need to be justified. Most companies are <u>not</u> better split apart or taken over by financially oriented managers. However, Allegis could not make its own case

believable. It is a great example of a whole which submerged and diminished both the investment and operating value of its parts. Each of Allegis' five main components look as though they have emerged as healthier entities with better capitalization, better prospects for growth, higher morale and greater economic value than was the case prior to our activities.

Gillette is a different case in which we also took our point of view to shareholders in an effort to force constructive change. In October of 1987, the Coniston Group was on the way to becoming the largest shareholder of Gillette through the accumulation of approximately seven million shares at a current value of $266 million. It had been our analysis that the company was both poorly managed and improperly valued by the public market. The poor management had to do with issues of corporate governance as well as a lack of operating performance. In November of 1986 Gillette had greenmailed its then largest shareholder, Revlon, in an attempt to avoid a purchase by Revlon that could have provided a large premium to shareholders. It had also adopted a number of anti-takeover measures, including a poison pill, bi-law changes and the support of the Massachusetts state takeover statute. All this by a company incorporated in Delaware with a majority of its earnings outside the United States as well as outside the State of Massachusetts. All this by a company whose operating earnings per share had shown marginal improvement for many years prior to the greenmailing of Revlon. All this by a company whose aging, uncreative management team had failed to develop its consumer products franchise to the degree that would support its bloated management structure. Gillette began massive layoffs in an attempt to become more competitive.

It is interesting that management has done everything in its power to thwart the maximisation of shareholder value through a merger or acquisition, but it

has never explained why such an event should be avoided. We believe that Gillette is an underperforming company which is a greater opportunity for improvement by a new owner, an owner willing to pay a substantial premium for the right to make those improvements. This does not mean a break-up, dismemberment, liquidation or any of the other negative sounding actions that have been suggested. As most of you know, we fought a proxy contest in order to elect one-third of the Board of Directors of Gillette as independent representatives of shareholders who would then seek to overturn the abusive practices of the past and find a single buyer for all of Gillette. On April 21, we lost that proxy contest by approximately 3% of the outstanding shares.

We are now in court here in Boston because we believe that Gillette management bought victory in the proxy contest by violating the solicitation rules. Those rules are meant to discourage the use of false and misleading information to solicit proxies. We believe that management disclosures of their various contracts with potential buyers of Gillette should have been made public and that statements by its officials and investment bankers should have been more truthful in their description of the Coniston Group and our efforts to maximize shareholder value. This issue will be decided by the Court in the near term and I do not wish to go into the specifics of the case here.

I would like to end by saying that in the case of Allegis and in many earlier examples of shareholder activity by Coniston, we are able to achieve very positive results for shareholders and indirectly for other stakeholders through the available machinery of corporate democracy. In the case of Gillette our plan was thwarted by the heavy handed interference in the process

by management and its advisors. Had we won, or if we win in the future, I believe that similarly satisfactory results will obtain despite the high level of anxiety that now exists in the company and in some quarters of this Boston community.

My position is not a doctrinaire endorsement of all takeovers nor a blanket condemnation of all management. However, I believe that takeovers are a way of sanitizing the system and forcing better management and more efficient allocation of resources. I think that corporations and markets must be regulated, but that the focus of most of the regulation should be at the federal level not at the state level. Furthermore, the competition between states to pass more protective laws for their own companies (even if those companies are really incorporated in another state) only serve to entrench management, foster less competitive enterprises and ultimately lead to the dislocation and disappointment of the work force once the inevitable rationalizations are required by the larger economic environment.

In order to avoid such dislocations we need good managers hired by responsible directors elected by knowledgeable shareholders. Corporate democracy is in need of rigorous surveillance and some degree of overhaul. Boards of directors are not doing the job that the system requires. They need to be more independent of the executive management and they need to be more responsive to the owners whom they represent. If the boards are made more accountable, managers will become more accountable. When that happens, we will see fewer hostile takeovers because the level of managerial effectiveness and corporate competitiveness will have increased to the point that opportunities will invite partners rather than raiders.

Paul E. Tierney, Jr.

Statement of Joseph E. Mullaney to the Commission to Review Massachusetts Anti-Takeover Laws

[Intro] Secretary Alviani, Members of the Commission, my name is Joseph E. Mullaney. I am a Senior Vice President and the General Counsel of The Gillette Company. I appear today at the request of the Staff of the Commission to express support for Chapters 110 D and 110 E of the General Laws of the Commonwealth, enacted in July 1987, commonly known as the Massachusetts Control Share Acquisition Act. I will also identify certain continuing problems affecting Massachusetts business corporations and the economic well-being of the Commonwealth which this Commission may wish to consider in its recommendations for additional legislative and executive action.

[Imminent Federal Legislation] Before beginning my remarks, I want to make it clear that the questions being addressed by this Commission and other state executive and legislative bodies may rapidly become moot if Congress enacts certain amendments to currently pending federal legislation which would severely limit the historical role of the states in corporate governance and the protection of

SHAREHOLDER RIGHTS. AMENDMENTS TO LEGISLATION NOW UNDER ACTIVE CONSIDERATION BY THE U.S. CONGRESS INCLUDE PROVISIONS TO PREEMPT STATE ACTION IN CONNECTION WITH TENDER OFFERS AND OTHER TAKEOVER MANEUVERS. BECAUSE OF THE VITAL INTERESTS OF THE COMMONWEALTH IN PROTECTING

A) THE RIGHTS OF SHAREHOLDERS WHOSE INTERESTS ARE CREATED BY STATE LAW AND

B) ITS ECONOMIC WELL-BEING TO WHICH MASSACHUSETTS-BASED CORPORATIONS CONTRIBUTE SO SUBSTANTIALLY,

I URGE THE ADMINISTRATION TO CONSIDER PROMPT ACTION TO ENLIST THE AID OF THE ENTIRE MASSACHUSETTS CONGRESSIONAL DELEGATION TO OPPOSE PREEMPTIVE FEDERAL LEGISLATION.

[MASS. LAW]

THE MASSACHUSETTS CONTROL SHARE ACQUISITION ACT IS SOUND AND SENSIBLE LEGISLATION. ITS CLEAR PURPOSE IS TO BRING A DEGREE OF FAIRNESS TO THE TAKEOVER PROCESS BY PROVIDING THE DIRECTORS OF A MASSACHUSETTS-BASED CORPORATION A REASONABLE PERIOD OF TIME WITHIN WHICH TO EVALUATE CAREFULLY A HOSTILE TENDER OFFER, AS WELL AS ALTERNATIVE BUSINESS PROPOSALS AND TO CONSIDER WHICH ALTERNATIVE IS IN THE BEST INTERESTS OF THE CORPORATION AND ITS SHAREHOLDERS

AND THE RELATED INTERESTS OF THE EMPLOYEES, SUPPLIERS, CUSTOMERS AND THE COMMUNITIES IN WHICH IT OPERATES. IT ALSO ALLOWS SHAREHOLDERS A REASONABLE PERIOD OF TIME TO EVALUATE THE RAIDER'S PROPOSAL AND MANAGEMENT'S RECOMMENDATIONS. THIS LAW IS A SENSIBLE STEP IN THE DIRECTION OF PROVIDING A MORE LEVEL PLAYING FIELD BETWEEN MANAGEMENT AND THE RAIDERS.

THERE ARE TWO FUNDAMENTAL GOALS OF STATE LEGISLATION SUCH AS CHAPTERS 110 D AND 110 E OF THE GENERAL LAWS:

o TO PROMOTE SHAREHOLDER DEMOCRACY, THAT IS, TO PROVIDE A REASONABLE OPPORTUNITY FOR COMMUNICATING MEANINGFUL INFORMATION TO SHAREHOLDERS AND ALLOWING SHAREHOLDERS A REASONABLE PERIOD OF TIME FOR EVALUATING THAT INFORMATION.

o TO PROTECT THE LEGITIMATE INTERESTS OF THE COMMONWEALTH IN EMPLOYMENT, THE ECONOMY AND THE TAX BASE, TO WHICH MASSACHUSETTS BASED BUSINESS CORPORATIONS CONTRIBUTE SO SIGNIFICANTLY.

[MORE ACTION NECESSARY]

THESE RECENTLY ENACTED LAWS ARE A FIRST STEP IN THE DIRECTION OF ACHIEVING THESE GOALS, BUT THERE IS MORE TO BE DONE IN THE WAR BETWEEN WALL STREET AND MAIN STREET. THE COMMONWEALTH HAS THE AFFIRMATIVE

RESPONSIBILITY TO TAKE LEGISLATIVE AND EXECUTIVE ACTION TO PREVENT OR AT LEAST MINIMIZE THE TACTICS OF THE TAKEOVER SPECIALISTS WHICH DEPRIVE INDIVIDUAL SHAREHOLDERS OF A FAIR OPPORTUNITY TO MAKE IMPORTANT INVESTMENT DECISIONS AND WHICH THREATEN TO STRIP AND LIQUIDATE THE ASSETS OF MASSACHUSETTS-BASED CORPORATIONS. BEFORE IDENTIFYING THE PROBLEM AREAS WHICH CONTINUE TO EXIST AND MY SUGGESTIONS FOR ADDITIONAL ACTION BY THE COMMONWEALTH, I WOULD LIKE TO CALL TO YOUR ATTENTION ONE OF THE LATEST EXAMPLES OF THE PROFESSIONAL WALL STREET MARKET PLAYERS, SELF-SERVING INVESTMENT STRATEGIES - A NEW PHENOMENON WHICH IS A SERIOUS DANGER TO VIRTUALLY ALL PUBLICLY OWNED CORPORATIONS IN THE COMMONWEALTH OF MASSACHUSETTS AND THROUGHOUT THE U.S.

[STRATEGIC BLOCK INVESTING]

THIS PHENOMENON IS SOMETIMES CALLED "STRATEGIC BLOCK" INVESTING. IT IS POTENTIALLY MORE SERIOUS THAN THE WAVE OF CORPORATE TAKEOVERS THAT HAS ENGULFED AMERICAN COMPANIES BECAUSE THE LAWS AND RULES GOVERNING CORPORATE TAKEOVERS DO NOT APPLY.

SO-CALLED "STRATEGIC BLOCK" INVESTING INVOLVES:

- O THE FORMATION BY WALL STREET MARKET PLAYERS OF LARGE POOLS OF CAPITAL, MUCH OF WHICH MAY BE FOREIGN-SOURCED, BASED ON PROMISES TO THE INVESTORS IN THE POOLS OF SHORT TERM YIELDS THAT ARE FAR IN EXCESS OF CONVENTIONAL YIELDS.

- O THE TAKING OF A SIGNIFICANT EQUITY STAKE IN A COMPANY, NOT TO MAKE A TENDER OFFER, BUT WITH A VIEW TO PUTTING A COMPANY "IN PLAY," AND FORCING ITS SALE OR BREAK-UP BY THREATENING A PROXY CONTEST, CONSENT SOLICITATION, OR THE INITIATION OF A "LOW BALL" OR INADEQUATE TAKEOVER BID BY THIRD PARTIES.

THE TARGETS OF THE "STRATEGIC BLOCK" INVESTOR MAY NOT BE THE USUAL CANDIDATES ATTACKED BY TAKEOVER ARTISTS. RATHER, THEY CAN BE COMPANIES WITH SKILLED MANAGEMENT, WELL-DEPLOYED ASSETS, EXCELLENT PERFORMANCE AND PROSPECTS AND INVESTMENT RETURNS THAT ARE WELL ABOVE WHAT WOULD BE OBTAINABLE IN THE STOCK MARKETS GENERALLY IN THE NEAR OR LONGER TERM. THEY CAN BE ANY COMPANY

WHOSE PERCEIVED SALE OR BREAK UP VALUE HAPPENS TO BE MORE THAN ITS THEN CURRENT STOCK PRICE -- VIRTUALLY ANY PUBLICLY OWNED COMPANY.

HOW CAN "STRATEGIC BLOCK" INVESTING BE EFFECTIVE AGAINST WELL-MANAGED, EXCELLENT-PERFORMING COMPANIES? THE ANSWER IS THAT SHARES OF STOCK TYPICALLY TRADE AT A SUBSTANTIAL DISCOUNT TO "SALE PRICES," WHICH RECOGNIZE THE INHERENT PREMIUM FOR CORPORATE CONTROL. EQUALLY IMPORTANT, CURRENT STOCK MARKET PRICES TEND TO REFLECT COMPARISONS WITH OTHER INVESTMENT OPPORTUNITIES AND MAY NOT FULLY REFLECT THE INTRINSIC, LONGER-TERM VALUES OF INVESTMENT IN R&D, IN PEOPLE, AND IN NEW PRODUCTS WHICH ARE MADE BY COMPANIES THAT ARE BEING WELL MANAGED FOR THE NEAR AND LONGER TERM. "STRATEGIC BLOCK" INVESTING SEEKS TO FORCE THE IMMEDIATE REALIZATION OF THE GAP BETWEEN STOCK MARKET TRADING PRICES AND SALE PRICES, REGARDLESS OF WHETHER GREATER STOCKHOLDER VALUE CAN BE REALIZED OVER THE NEAR OR LONGER TERM BY THE COMPANY'S CONTINUED INDEPENDENCE OR LATER SALE.

IF A COMPANY WITH EXCELLENT EARNINGS AND PROSPECTS AND SUPERIOR STOCK MARKET PERFORMANCE, COULD BE FORCED TO AN UNTIMELY SALE OR BREAK-UP BY A GROUP OF MARKET PLAYERS, VIRTUALLY EVERY MAJOR PUBLICLY OWNED CORPORATION IN AMERICA IS AT RISK.

STRATEGIC BLOCK INVESTING IS THE LATEST IN THE ARSENAL OF INVESTMENT STRATEGIES WHICH ELEVATE THE SHORT-TERM INTERESTS OF THE MARKET SPECULATORS OVER THE LONGER TERM INTERESTS OF CORPORATIONS, INDIVIDUAL SHAREHOLDERS, EMPLOYEES, THE COMMUNITIES, CUSTOMERS, SUPPLIERS AND OTHER CONSTITUENCIES WHICH THE COMMONWEALTH HAS A DUTY TO PROTECT. WHAT IS INVOLVED HERE IS A STRUGGLE - A STRUGGLE BETWEEN THE SELF-SERVING SHORT TERM PHILOSOPHY OF WALL STREET PROFESSIONALS AND THE GREATER, BROADER AND LONGER-TERM INTERESTS OF THE INVESTING PUBLIC AND THE COMMONWEALTH'S ECONOMY.

WHAT ACTION CAN BE TAKEN TO ADDRESS THESE PROBLEMS? I AM NOT SURE THAT STRATEGIC BLOCK INVESTING CAN BE DEALT WITH DIRECTLY BY STATE ACTION. SOME STEPS CAN BE TAKEN HOWEVER AND I RECOMMEND YOUR CONSIDERATION OF THE FOLLOWING:

[LONG-TERM/ OTHER CONSTITUENCIES]

FIRST, IT SHOULD BE MADE EXPRESSLY CLEAR IN MASSACHUSETTS, AS IT HAS BEEN IN A NUMBER OF OTHER STATES, THAT DIRECTORS MAY CONSIDER MANY INTERESTS WHEN DETERMINING WHAT IS IN THE BEST INTERESTS OF THE CORPORATION AND ITS SHAREHOLDERS INCLUDING:

A) LONG-TERM AS WELL AS SHORT-TERM INTERESTS;

B) THE POSSIBILITY THAT THOSE INTERESTS MAY BEST BE SERVED BY THE CONTINUED INDEPENDENCE OF THE CORPORATION;

C) THE INTERESTS OF OTHER CONSTITUENCIES, SUCH AS, EMPLOYEES, SUPPLIERS, CREDITORS, AND CUSTOMERS, AND

D) THE ECONOMY OF THE STATE, REGION AND NATION AND OTHER COMMUNITY AND SOCIETAL INTERESTS.

SIMILAR LEGISLATION HAS BEEN ADOPTED BY A NUMBER OF STATES, INCLUDING ARIZONA, ILLINOIS, MAINE, MINNESOTA, MISSOURI, NEW MEXICO, NEW YORK AND OHIO. IN MASSACHUSETTS, THIS LEGISLATION WOULD NOT BE NEW, BUT RATHER A CLARIFICATION OF EXISTING LAW. THE RESTRICTIVE VIEW, THAT A CORPORATE DIRECTOR MUST ALWAYS ACT IN THE NARROW AND SHORT-TERM FINANCIAL INTERESTS OF SOME SHAREHOLDERS, HAS NEVER BEEN ARGUED AND SHOULD NOT BE ADOPTED.

[FREEZE LAW TO PREVENT 2ND STAGE MERGERS]

SECOND, DETER THE RAIDER'S PRACTICE OF FINANCING ITS SPECULATIVE VENTURES BY STRIPPING AND LIQUIDATING THE ASSETS OF A TARGET MASSACHUSETTS CORPORATION, BY ADOPTING A "FREEZE" LAW SIMILAR TO THE NEW YORK (5 YEAR) OR DELAWARE (3 YEAR) LAWS WHICH POSTPONE SECOND-STAGE MERGERS UNLESS BOARD APPROVAL OR A SUPER-MAJORITY SHAREHOLDER APPROVAL IS OBTAINED. THIS WILL HELP ENSURE FAIR-PRICED AND ADEQUATELY FINANCED TAKEOVER OFFERS.

THAT CONCLUDES MY REMARKS. THANK YOU FOR THE OPPORTUNITY TO APPEAR AND FOR YOUR ATTENTION.

I WILL BE HAPPY TO ANSWER QUESTIONS OTHER THAN THOSE THAT RELATE TO THE RECENT PROXY CONTEST BETWEEN GILLETTE AND THE CONISTON GROUP BECAUSE OF THE PENDING LITIGATION RELATING TO THAT CONTEST.

REMARKS OF HOUGHTON MIFFLIN COMPANY FOR THE COMMISSION TO REVIEW

MASSACHUSETTS ANTI-TAKEOVER LAWS

June 22, 1988

Thank you Chairman Alviani, Chairman Eustace, Lieutenant Governor Murphy, members of the Commission, and guests for giving us this opportunity to testify before you today. You are to be commended for undertaking this review of our Commonwealth's anti-takeover laws in view of our rapidly changing financial and regulatory environment. We are deeply concerned about the serious implications of hostile takeovers of independent publishers and I welcome the opportunity to share those concerns with you.

Houghton Mifflin Company, a publicly held Massachusetts corporation, is a major publisher of instructional materials for the nation's schools and colleges, general books for adults and children, dictionaries and other reference materials, and computer software products. We have been a Boston-based publisher for more than 150 years and much of America's literary heritage first appeared over our imprint. We employ about 1,100 people in Massachusetts; our total staff, nationally, is more than 2,100. Our annual Massachusetts payroll is more than $36 million, and we spend substantial amounts with printers, paper merchants, trucking companies, and other suppliers of goods and services throughout the state.

The Company is a dedicated supporter of charities and educational and cultural institutions, most of which are in the Greater Boston area. Our annual expenditure in support of our commitment to charitable and non-profit efforts

is about $2.5 million, which includes a matching funds program of up to $1,500 per year for each employee. In addition, we and our employees participate in numerous programs for educational and community development in Boston and its surrounding communities.

Serious issues are being raised about plant closings, the loss of a significant number of jobs, and disruptions of communities' economic bases resulting from hostile takeovers of companies. I know you have much information on these, and, as a local corporation, we share in those concerns. But, I wish to call your attention today to another issue which we think is unique to our publishing business. We believe there is a serious risk to our nation's schools, their educational programs, and our school children when an independent publisher of instructional materials is the target of a hostile takeover. This can be even more serious, in our opinion, if the hostile takeover effort comes from a foreign source.

We are deeply concerned that hostile acquisition of independent publishers will result in less diversity and fewer objective and comprehensive materials for schools and colleges. This is primarily because we see such acquisitions resulting in diversion of a publishing company's earnings to other business with a corresponding reduction in reinvestment of earnings in development and advancement of instructional innovations. Further on in this statement I shall illustrate the point with an example of need for reinvestment.

Our fears are not merely speculative. The April 25, 1988, Wall Street Journal carried a feature article on the battle between two publishing giants - West

Germany's Bertelsmann AG and France's Hachette S.A. - to become the biggest in Europe. They are both active acquirers of U.S. publishing companies. Bertelsmann's major U.S. acquisition is Doubleday Company, including Dell and the Literary Guild. Hachette recently acquired Grolier Corp. in a hostile transaction. Bertelsmann is now the world's largest media company, and Hachette claims fourth place.

The Journal stated, "The strategy behind their acquisitions is double-sided. Both corporations think they made shrewd purchases of solid companies relatively cheaply because of the low value of the dollar against their home currencies. Both think they can use their European management and distribution techniques to increase cash flow from their U.S. units. (Emphasis added.) That cash will soon be needed back home. European companies in all fields have begun frantic dashes for growth before 1992 when most common market barriers will fall and competition within Europe will increase." A copy of the complete article is attached.

More than 100 years of experience developing instructional materials have given Houghton Mifflin Company a thorough understanding of responsible educational publishing. It is our long-range goal to continue to make substantive and unique contributions to the quality of education by shaping, developing, and distributing educational materials that enhance teacher effectiveness and student mastery. Ongoing service and support to the classroom teacher is an integral part of our commitment to the teaching/learning process.

We publish educational materials for all major elementary, secondary, and college subject areas. These materials include student textbooks and workbooks, teachers' manuals, enrichment and remedial resources and instructional management systems, standardized tests and scoring services, and professional development materials for teachers and school administrators. In order to address a variety of educational needs and to meet the demands of the market, these materials take many forms, ranging from printed books to software for computer-assisted and computer-managed instruction, interactive databases of information, and training modules on video cassettes.

It takes time and it takes money to provide these materials and remain competitive. Industry figures show that on average, educational publishers annually reinvest 40% to 50% of every dollar of cash inflow into new and revised editions of textbook programs.

It is estimated that the cost to develop an entirely new elementary school reading program, for example, is about $20 million and as many as seven years of work. Commonly, a minor revision is needed in three years to keep up with current research and development, requiring another $3 to $5 million, and in three more years, a major revision calls for an additional $8 to $10 million investment. Keep in mind the relative significance of this amount in the context of an industry for which the total annual sales to elementary and secondary schools are less than $2 billion.

The following extract from a speech by Dieter von Holtzbrinck, the German publisher, appeared in the December 19, 1986, Publishers Weekly:

"If we feel a strong cultural responsibility to keep German literary publishing alive and flourishing, we need to have parts of our business that can bring in more cash but that are also related to the whole. We decided to strengthen our newspaper publishing, produce school textbooks and come to America."

If an independent publisher of educational materials were acquired for such a purpose it would not survive. It would not be able to reinvest the funds needed to provide up-to-date materials. The result would be loss of the diversity in instructional approaches which the schools require.

Concentration of publishing, whether resulting from domestic or foreign acquisitions, would also diminish opportunities for authors since there would inevitably be fewer basic programs. The national debate over the accountabilities of our school programs has certainly focused on the need for new approaches, often the major contributions of textbook authors whose own teaching experiences are sources of publishers' innovations in pedagogies.

There is one further point about the detrimental effect of diversion of funds as it applies to publishers of instructional materials. A fledgling publisher of a novel, a regional work of non-fiction, or a special interest book for the general reading public can begin business with a manuscript, the cost of a first press run, limited advertising, and his own time. Indeed, there are numerous success stories of just such ventures, several in Massachusetts.

However, the economic commitment required for meaningful participation in the textbook market is more significant. It is doubtful that new entrants could emerge today to replace those that disappear through mergers or acquisitions. The extended periods of planning, market research, author selection, writing, editorial and design preparation, classroom testing, national selling, production, and marketing require many years and absorb great investments.

So far I have touched on issues of concern to independent educational publishers in general. Houghton Mifflin Company feels strongly about them in terms of its ability to continue as a responsible educational publisher, as a long-time Massachusetts corporation, and as a member of Boston's business community.

Over 80% of our 1987 net sales of $343.4 million were to the educational market. Two thirds of the total came from sales to elementary and secondary schools. We are committed to our unique role as a publisher by creating and making available significant contributions to our nation's culture through our instructional materials for schools, a role which has produced an above-average return to our long-term stockholders. We are convinced that the inevitable and predictable result of a hostile takeover of an independent publisher is an unfortunate compromise of the principles needed to fulfill these responsibilities. This begins with management's inability to focus on long-term objectives because of the imposed requirement that it solve immediate crises. This carriers all the way to customer concerns about future service and product reliability, especially if the publisher has been acquired by foreign ownership.

In view of the foregoing, I urge you to give serious consideration to the importance of independent educational publishers to the nation's schools and the opportunity Massachusetts has to play an active role in preserving that valuable asset. It seems clear to us that the issue will have to be resolved by the states since our federal government seems indifferent to the need to protect our cultural industries in the way foreign governments protect theirs.

Many foreign countries have restrictions on foreign ownership and anti-trust restrictions limiting mergers involving vital cultural and educational programs. The restructions have been exercised to preclude foreign ownership, yet their own companies have been acquiring U.S. publishers as cited earlier. The Canadian government's investment policy mandates that when a foreign company acquires a company that has a Canadian operation in a culturally sensitive area, it must sell controlling interest in the Canadian unit within two years. In the U.K., the Secretary of State for Trade and Industry recently ruled that the purchase of a 50% interest in the British publisher Book Club Associates by foreign publishers Bertelsmann and Les Presses would be against the public interest and should not be allowed. Yet shortly thereafter, less than two months ago, the British firm, Pearson, acquired Addison-Wesley, a textbook publisher headquartered in Reading, Massachusetts.

Should Houghton Mifflin Company be the target of a hostile takeover, the members of our Board of Directors would have greater assurance of their ability to act responsibly if S.1502 (An Act Clarifying the Responsibilities of Corporate Directors) were enacted. The nation's schools are among the customers whose long-term interests our directors would then be able to consider. I have already commented on our commitment to them.

Our authors represent another major constituency whose interests we consider to be critical in any such decision. Our relationship with our authors is a professional one based on mutual confidence. It is that mutual confidence which as made Houghton Mifflin a successful and enduring publishing house. We hear regularly from authors who are concerned about the potential for negative effects on their cherished work should their publisher be acquired. We would not want to be forced into a position that destroys that confidence. We count on them as they count on us.

In conclusion, the impact of a hostile takeover effort on Houghton Mifflin Company, as a Massachusetts corporation, would undoubtedly be comparable to the impact on any other employer of the same size. However, our role as the publisher of instructional materials for millions of American children gives another, unique dimension that goes beyond the traditional "bottom line" considerations. The publishing industry's principal reference source, Literacy Market Place, lists the names of 112 book publishers located in Massachusetts. These, plus the many printing companies and software producers, make publishing a major Massachusetts industry. A few years ago, six of the nation's major independent publishers of educational materials were on that list. Today, five of them: Addison-Wesley, Allyn & Bacon, Ginn & Co., D.C. Heath, and Little Brown are all subsidiaries of larger corporations. Only Houghton Mifflin remains independent.

The nation's present financial course reduces the opportunities for diversity by permitting concentration of the domestic publishing industry and, thereby, turns over the custody of its culture to foreign control. We believe this course will have tragic consequences. We are grateful to you for providing us with this occasion to express our concerns and urge you to recommend appropriate action at the state level before it is too late.

Thank you.

Paul D. Weaver
Secretary and General Counsel
Houghton Mifflin Company
One Beacon Street
Boston, Massachusetts 02108

Media Race

Two Publishing Giants Fight for Dominance In Europe of the 1990s

Germany's Bertelsmann Vies With Hachette of France, And U.S. Is a Battlefield

The Biggest vs. the Barracuda

By PHILIP REVZIN
Staff Reporter of THE WALL STREET JOURNAL

PARIS — The Germans struck first, launching a blitzkrieg far from home followed by lightning forays into the enemy's back yard. The French, caught off guard, bided their time before mounting a two-pronged counterattack against the German expeditionary forces. The outcome remains in doubt.

No, you haven't missed the start of World War III. This raging battle isn't being fought with tanks and guns but with women's magazines and encyclopedias, book clubs and television listings. It pits West German publishing giant Bertelsmann AG against French publishing giant Hachette S.A. To the victor goes dominance of what could soon be the world's biggest single consumer market, 320 million Europeans.

The current battleground: the U.S.

The latest moves in the struggle are Hachette's twin acquisitions this month of Grolier Inc. and Diamandis Communications Inc. for a total of $1.16 billion, which suddenly makes the French company the world's biggest publisher of encyclopedias and magazines. Hachette's total annual revenues will now approach $4 billion.

Rival's Purchases

Two years ago Bertelsmann stormed into the U.S., buying Doubleday Inc. and the records division of RCA Inc. for a total of $800 million. This made the privately held West German company the world's biggest media conglomerate, with projected 1988 revenue of $6.3 billion.

Now the French publish the Book of Knowledge and American Photographer magazine, and the Germans publish Lee Iacocca and sell Whitney Houston albums.

The ways Bertelsmann and Hachette are waging their struggle reflect two companies with diametrically different styles, and a look at these two emerging European-American publishing giants may offer a glimpse of where the media future lies on both sides of the Atlantic.

The strategy behind their acquisitions is double-sided. Both corporations think they made shrewd purchases of solid companies relatively cheaply because of the low value of the dollar against their home currencies. Both think they can use European management and distribution techniques to increase cash flow from their new U.S. units.

Eyes on 1992

That cash will soon be needed back home. European companies in all fields have begun frantic dashes for growth before 1992, when most Common Market internal trade barriers will fall and competition within Europe will increase. Convinced that they will have to be bigger to survive under the new rules, they have been reorganizing, buying smaller rivals, and making cross-border alliances. French companies like Hachette see German companies like Bertelsmann as the main threat. German companies know they are ahead, and aim to make the most of their advantage.

"With the dollar where it is, there are opportunities now in the U.S. that won't be there in two, five or 10 years' time," says John Perriss, world-wide media director for Saatchi & Saatchi Co. in London. Mr. Perriss's own company has become the world's biggest advertising agency largely through U.S. acquisitions. "Good and profitable acquisitions now," he says, "will fill your war chest for the real fight back home."

Another reason European media companies are leapfrogging borders is that they are outgrowing their home markets. They can't yet easily expand across those borders because of lingering trade barriers. Hemmed in, they are being nibbled at by government restrictions and perky competition.

Antitrust Rule

Bertelsmann is banned by antitrust authorities from making any more German media acquisitions. On top of that, its home market has stagnated; Bertelsmann's German revenue grew by only 6% last year, compared with a 31% surge in revenue from outside Germany, which now accounts for 66% of the total.

Hachette, which claims it is now the world's fourth-biggest media company, behind Bertelsmann, Capital Cities/ABC Inc., and Time Inc., is being driven abroad in part by challenges at home. Group de la Cite, a recent agglomeration of publishing companies, is in most of Hachette's lines and owns half of the world's biggest book club, which sells at great profit 26 million books a year to one Frenchman in every five. More worrying for Hachette: The other half of the book club belongs to Bertelsmann, which manages it.

Wall Street Journal 4/25/88

This coming battle for Europe is already having far-reaching effects in the U.S. Bertelsmann has brought in fresh management to revive Doubleday and has slashed overhead at RCA Records. Hachette's innovative Premiere and Elle magazines, published in the U.S. in a joint venture with Rupert Murdoch's News Corp., have shaken up the magazine industry, and Hachette promises more new U.S. magazines.

It isn't always easy, of course. Publishing analysts on both sides of the Atlantic say Hachette probably overpaid by shelling out $712 million for 13 Diamandis magazines; two years ago Hachette had unsuccessfully bid just $600 million for the same magazines and seven others when they belonged to CBS Inc. Bertelsmann's Gruner & Jahr subsidiary took an embarrassing $30 million hit in 1979 when it tried to launch a U.S. version of GEO, its glossy natural-science magazine. That same year, Daniel Filipacchi, Hachette vice president and the mastermind of Elle and Premiere magazines, flopped in the U.S. with an attempted revival of Look magazine.

And there is always the danger that, by basing their growth firmly in the English-speaking world, the French and German companies will provoke counterattacks by British or Americans. "I see 10 surviving, huge media companies in the next 10 years," says Brownen Maddox, publishing-industry analyst for Kleinwort Grieveson Securities in London. "Six or seven will be American, two or three may be British. Bertelsmann will be there, and probably Hachette."

Flashy Boss

Hachette, a 162-year-old, until recently sleepy publisher of French schoolbooks, is now headed by a flashy entrepreneur who likes to project the breezy sophistication of Elle magazine combined with an iron will. Its modern era began in 1981 when it was acquired by defense contractor Matra S.A. and Matra's chairman, Jean-Luc Lagardere, now 60 years old.

Ever-tanned, with a politician's charisma, Mr. Lagardere not only runs Hachette and Matra, which makes the Mistral surface-to-air missile; he also recruits expensive stars for his Matra-Racing soccer team and pops up now and then behind a microphone on his radio station Europe 1. Before Mr. Lagardere took over Hachette, it was a money-losing company whose greatest achievement had been selling 160 million copies of a French spelling book. He transformed the company, whose nickname was "the green octopus" because its newspaper delivery vans were green and its tentacles spread all over, into a cash-rich barracuda.

At last week's Paris Book Fair, Hachette stands dominated the middle of the huge exhibition hall, displaying comic books (a serious matter here), travel guides, cookbooks, potboilers, and political treatises by or about virtually every French presidential candidate. One of every three books sold in France comes from Hachette. Elle magazine now sells 3.6 million copies a month in 13 countries, including China. The French equivalent of TV Guide, Tele 7 Jours, sells 3.2 million copies a week. With its recent U.S. buys, Hachette, says it will sell this year 650 million copies of 74 different magazines in 10 languages.

Knocks Along the Way

Along the path to this peak, Hachette has taken some knocks. Mr. Lagardere had his heart set on taking over France's leading television channel, TF1, when it was privatized last year and combining it with the radio station into a Europe-wide broadcasting power. Instead, the government sold the TV station to a construction mogul. Mr. Lagardere then tried several prototypes for a new daily newspaper in France, none of which got past the testing stage. He still says he wants to expand into TV and newspapers.

And he is still bitter about losing TF1. "It would have been a big help in the coming hand-to-hand combat with Bertelsmann," he says. As compensation, the two U.S. acquisitions should swell Hachette's treasury by 5 billion francs (about $1 billion) over the next 10 years. That money, Hachette executives say, will be used for expansion in all areas of communications in countries where English, French and Spanish are spoken. The goal: Catch Bertelsmann.

"I ask myself constantly," says Mr. Lagardere, "how a company whose native language is spoken by so few people can become the biggest media company in the world? The answer is amassing financial resources and conquering the English-speaking world. Our challenge is to get into the top ranks with them and stay there. And we're going to go all the way."

Bertelsmann has come a long way from Carl Bertelsmann's first hymnal 135 years ago. The media company's offices, warehouses and compact-disk factory dominate the small North German town of Guetersloh, otherwise known for its pumpernickel bread. The company isn't flashy, but it is a supremely efficient generator of money.

Bertelsmann's modern era reflects the economic miracle in West Germany since World War II. Its factories were flattened

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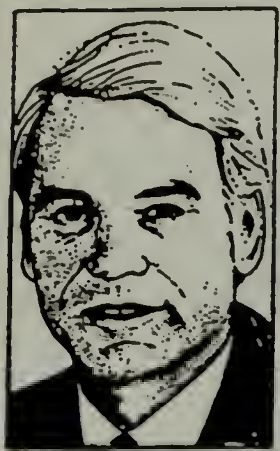
Bertelsmann AG



Mark Woessner

1988 estimate

Revenue: $6.3 billion

Net Income: $157 million

Employees: 42,000

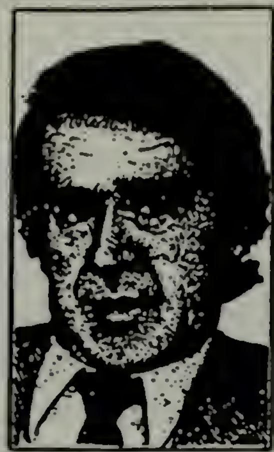
Countries where present: 25

Principal U.S. Properties:

RCA Records (Labels include RCA, Arista, Ariola)	$1.08 billion*
Doubleday Inc. (Includes Bantam, Dell, The Literary Guild, Doubleday Book and Record Clubs)	$500 million*
Brown Printing Co.	$335 million*
Parents Magazine	Circ.: 1.8 million

*1987 sales estimate

Hachette S.A.



Jean-Luc Lagardere

1988 estimate

Revenue: $3.9 billion

Net Income: $45 million

Employees: 26,000

Countries where present: 36

Principal U.S. Properties:

Grolier, Inc. (1987 sales)	$424 million
Curtis Circulation Co. (1986 sales)	$210 million
Woman's Day	Circ.: 6 million
Elle	Circ.: 1 million
Car & Driver	Circ.: 919,000
Popular Photography	Circ.: 751,000

by British bombers, and the senior surviving member of the owning family, Reinhard Mohn, spent three years in a prison camp in Kansas. When he got back home, Mr. Mohn rebuilt the company on book clubs, its growth engine during the 1950s.

Bertelsmann lost its way a bit in the 1960s when some ill-planned diversification led it into movie production and chicken farming. It got back to the basics of books and magazines in the 1970s, when it bought magazine publisher Gruner & Jahr and expanded into the rest of Europe. "When I came in 1968," recalls chief executive Mark Woessner, "Hachette was three times as big as we were. By the end of the '70s, we were twice as big as they were."

Bertelsmann gnaws at Hachette in France. Besides the half interest in the book club, Bertelsmann's Gruner & Jahr unit has successfully launched two women's magazines, Prima and Femme Actuel, under Hachette's nose in France. It also started a rival French TV maggazine two years ago, which sells 1.2 million copies a week but still loses money.

No Soccer Team

The company owns no professional soccer team and worries more about internal than external relations. Mr. Woessner, silver-haired at 49, has the charisma of an evangelist, not a movie star. During an interview in his large office overlooking Carl Bertelsmann Strasse, Guetersloh's main street, Mr. Woessner talks of quality, competence and partnership, a reference to the nearly 50% of Bertelsmann profit that goes into employee profit-sharing plans each year.

Mr. Woessner took Bertelsmann to America, first with the ill-fated GEO, then with the twin purchases of Doubleday and RCA Records. Bertelsmann has given itself until 1992 to digest these two companies but probably won't need that much time. Mr. Woessner says he doesn't plan another major U.S. buy soon, but he does want to build Bertelsmann's U.S. magazine business by adding new titles.

For the 1990s, Bertelsmann is trying to figure out a way into the Far East, where it currently has only a small music company, in Japan. But above all it is looking to television, first in Germany, where with a partner it owns a growing private TV network, RTL Plus, and later in Europe.

Mr. Woessner says Bertelsmann wants to be the best, not necessarily the biggest, and says "the competition will be everybody." But big moves into U.S. magazines and European television could pit Bertelsmann squarely against one competitor in particular: Hachette. Mr. Woessner smiles at this suggestion. "The competition," he repeats, "will be everybody."

Wall Street Journal 4/25/

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July 1, 1988

Ms. Barbara Waters
Assistant Secretary and Deputy General Counsel
Executive Office of Economic Affairs
Commonwealth of Massachusetts
One Ashburton Place--Room 2101
Boston, Massachusetts 02108

Dear Ms. Waters,

I am pleased that the Commission to Review Massachusetts Anti-Takeover Laws is devoting such thoughtful consideration to the issue, and I appreciate the opportunity to add to the record.

My firm represents large institutional investors. Contrary to some reports, they are long-term investors; their size alone makes some of the abuses of the past from constant "churning" no longer possible. They are interested in working with management to protect and enhance share value. Anti-takeover legislation of the kind adopted in Massachusetts makes that much more difficult.

You have already assembled substantial testimony from lawyers and economists. I am not going to give you a lot of econometric models and empirical data--you will get plenty of that from other people, and it will always show that these measures have an adverse impact on share value. They are bad for shareholders. I will align myself with John Pound and the others who have provided that documentation and then devote my comments instead to commenting on the way I think the problem should be framed. There are good takeovers and bad takeovers, and the distinction is not based on whether they are hostile or friendly, but on whether they are efficient; whether the shareholders and the rest of the economy will be better off with the takeover <u>in the long term</u> than without it. The shareholders are better equipped to make that decision than management or government, and as long as they have a system that permits them to make that choice based on their analysis, no further government intervention is wise or necessary.

Hostile takeovers and other corporate abuses are not the disease; they are just symptoms. Tinkering with them without addressing the underlying problem is like

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rearranging the deck chairs on the Titanic. If we fine tune takeover legislation without understanding the source of the problem--or just what makes it a problem--we will just drive the real problem further underground, and it will continue to eat away at our productivity and competitiveness.

The real disease is the collapse of the system of corporate governance, leaving management unaccountable to shareholders, and giving corporate management and raiders the incentives and the opportunity for exploitation and abuse. That is what has led to this redirection of corporate energy and imagination toward takeovers and defenses against takeovers and away from productivity. This is only possible because an integral part of the contract between those who provide the capital (shareholders) and those who provide the labor (corporate management) has all but disappeared, due to rampant inefficiency and abuse in the most important mechanism for shareholder communication--the voting of proxies. If it was restored, the market would permit only those mergers and acquisitions that benefit all parties.

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Your study should therefore include the dysfunctionality of the system of voting in major corporations. Corporations gather and count proxies with no supervision and no obligation to report the totals, with what economist Greg Jarrell calls "a remarkable home court advantage." Those who vote most of the shares have conflicts of interest due to their relationships with the corporations whose share they vote as customers or clients. The beneficial owners of more than a third of all stock are not even able to find out how the stock is voted on their behalf, so they have no way to evaluate the performance of their fiduciaries. The companies, on the other hand, do know how they vote, enabling them to put pressure on the trustees. And shareholders who want to become active find obstructions even beyond the almost insurmountable inefficiency of the proxy system. The two largest institutional investors have been turned down by major proxy solicitation firms, who decline on the grounds of possible reprisals from their other clients, corporate management. The empirical evidence demonstrating the

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result of those reasons is compelling.

Simply put, they show that the mechanisms for expression of shareholder opinion, principally voting, do not work. Conflicts of Interest in the Proxy Voting System, a valuable study by the Investor Responsibility Research Center, describes the existing dysfunctionality of the voting process with merciless precision. John Pound's study documents the failure of institutional investors to use their voting power to protect their assets. Contrary to the conventional wisdom that institutional investors, who have the resources for full-time, careful analysis of all aspects of the financial markets, will make more efficient choices than individual investors, his study demonstrated that the institutions consistently vote against their economic interest more often than the individuals.

According to a recent study published by the Employee Benefit Research Institute, some fund managers have routinely voted with management, with little or no attempt to analyze the economic impact of the proposals. Other fund managers have capitulated to pressure from their other clients and customers, commercial interests eclipsing fiduciary obligations. Still others have given up voting at all.

The EBRI report found that some plan sponsors do not know if their pension managers vote, or how they vote, or if they vote consistently. "Although most sponsors have a number of external managers, less than a quarter attempted to coordinate the voting of these managers...Perhaps more telling, 68 percent of sponsors with external voting did not know whether their managers ever cast a contradictory vote." Despite the fact that proxies voted by internal managers were more likely to be overseen by plan sponsors, and more likely to be subject to written guidelines on voting, EBRI found that they were just as likely to be voted inconsistently as those voted by outside managers.

The EBRI study is echoed in the findings of a recent survey by the Investor Responsibility Research Center, comparing the voting records of public and private pension funds. It reports that public funds are twice

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as likely to vote against antitakeover proposals as private pension funds. One possible explanation is that public funds vote most of their proxies in-house. In contrast, most proxies voted for private pension funds are voted by institutional fiduciaries, who are susceptible to management pressures. The implication is that more private funds would vote against antitakeover defenses if they were not subject to conflicts of interest.

I believe that it is this issue that is at the heart of the takeover problem. The proof of that is in the most recent proxy season, where adoption of state antitakeover laws like yours and revised tax treatment of greenmail combined to push contests for corporate control away from tender offers and into proxy contests, including one at Gillette that was so close it took weeks to find out who won. Your legislation did not accomplish its goal; it only changed the arena. And until shareholders are assured of a workable proxy system, that goal will never be accomplished.

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While there are limits on states' abilities to address this problem, some worthwhile options are available. I am enclosing a pending bill from the California state legislature that is a significant first step. Although it would apply to a limited number of institutional investors (because ERISA pre-empts state laws for those funds it governs), it sets an important standard by requiring those who manage funds for others to disclose how they vote those funds. I would urge the state of Massachusetts to consider such legislation, and to consider very carefully rescinding the anti-takeover legislation it has adopted.

I would be happy to provide any additional information that might be of assistance to you in this important investigation.

Sincerely,

Nell Minow

Nell Minow
General Counsel

TITUTIONAL
EHOLDER
CES, INC.

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AMENDED IN ASSEMBLY [illegible] 1987

AMENDED IN SENATE JUNE 23, 1987

AMENDED IN SENATE APRIL 27, 1987

SENATE BILL No. 1600

Introduced by Senator Garamendi

March 6, 1987

An act to add Sections 710 and 711 to the Corporations Code, relating to corporations.

LEGISLATIVE COUNSEL'S DIGEST

SB 1600, as amended, Garamendi. Securities: duty to disclose voting record.

Under existing law, a corporation is required to keep and maintain specified records, some of which are open to inspection upon a written demand to the corporation by any shareholder or holder by a voting trust certificate.

This bill would require persons possessing the power to vote specified shares of stock on behalf of another to maintain a record of the manner in which the shares are voted and to disclose ~~this information~~ *the voting record with respect to any matter involving a specified security* upon a reasonable written request to specified persons, including, among others, shareholders, beneficiaries, or contract owners of specified investment companies to the extent the company holds the shares for which the record is requested.

The bill would also ~~create a private cause of action to enforce the above provisions and would permit any person or entity to bring an action to petition the court for~~ *provide that in an action to enforce its provisions, the court may make* an award of costs and reasonable attorney's fees ~~if successful~~.

The bill would provide that the obligations to maintain and disclose the voting record do not commence until January 1,

1939.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 710 is added to the Corporations Code, to read:

710. *(a)* The Legislature finds and declares that:

~~(a) Many of the residents of this state are (1) the legal and beneficial owners of shares of stock of domestic or foreign corporations or (2) the beneficiaries of defined/benefit and defined/contribution retirement plans provided by entities which invest employee and employer contributions in the voting securities of domestic or foreign corporations in order to earn the moneys needed to meet pension payment obligations under these plans. The informed and active involvement~~

Many of the residents of this state are the legal and beneficial owners or otherwise the ultimate beneficiaries of shares of stock of domestic and foreign corporations, title to which may be held by a variety of intermediate owners as defined in subdivision (d). The informed and active involvement of such beneficial owners and beneficiaries in holding legal owners and, through them, management, accountable in their exercise of corporate power is essential to the interest of those beneficiaries and to the economy and well-being of this state.

The purpose of this section is to serve the public interest by ensuring that beneficiaries are informed as to how persons under subdivision (d) discharge their responsibilities to vote shares.

This section shall be construed liberally to achieve these purposes.

(b) Every person possessing the power to vote shares of stock on behalf of another shall maintain a record of the manner in which the shares were voted. The record shall be maintained for a period of 36 consecutive months from the date of the vote. ~~Signing a proxy on another's behalf and forwarding it or receiving an instrument for disposition does not constitute the power to vote.~~

(c) Upon a reasonable written request, the person ~~possessing the power to vote specified shares of stock on behalf of another, or a designated agent, shall disclose the voting record or any portion thereof to the person on~~ *possessing the power to vote shares of stock on behalf of another, or a designated agent, shall disclose the voting record with respect to any matter involving a specified security to the person on* whose behalf the shares were voted.

(d) For purposes of this section, a person on whose behalf shares are voted includes, but is not limited to:

(1) A beneficiary of a trust holding the shares entitled to receive information about the trust pursuant to Section 16061 of the Probate Code.

(2) A participant or beneficiary of an individual retirement account or employee benefit plan with regard to shares held for the benefit of the participant or beneficiary.

(3) A shareholder, beneficiary, or contract owner of any entity subject to Section 8 of the federal Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.), *as amended ("investment company"),* to the extent the entity holds the shares for which the record is requested.

(4) A beneficiary under paragraph (1), a participant or beneficiary under paragraph (2), or a shareholder, beneficiary, or contract owner under paragraph (3), with regard to a voting record of shares held by an underlying funding source, including, but not limited to, a common trust fund or investment company.

(e) *Signing a proxy on another's behalf and forwarding it for disposition or receiving voting instructions does not constitute the power to vote. A person forwarding proxies or receiving voting instructions shall disclose the identity of the person having the power to vote shares upon reasonable written request by a person entitled to request a voting record under subdivision (c).*

(f) For purposes of this section, if one or more persons has the power to vote shares on behalf of another, unless

a governing instrument provides otherwise, the person or persons may designate an agent who shall maintain and disclose the record in accordance with subdivisions (b) and (c).

~~(f)~~

(g) Except as otherwise provided by law or a governing instrument, a person maintaining and disclosing a record pursuant to this section may assess a reasonable charge to the requesting person in order to defray expenses of disclosing the record in accordance with subdivision (b). Disclosure shall be made within a reasonable period after payment is received.

~~(g) Any person described under subdivision (d) may bring an action to enforce this section.~~

~~(h)~~

(h) Upon the petition of any person who successfully brings an action pursuant to or to enforce this section, the court may award costs and reasonable attorney's fees.

(i) The obligation to maintain and disclose a voting record in accordance with subdivisions (b) and (c) shall commence January 1, 1989.

SEC. 2. Section 711 is added to the Corporations Code, to read:

711. (a) The Attorney General, upon complaint that a person is failing to comply with Section 710, may, in the name of the people of the State of California, send to that person notice of the complaint. If the answer is not satisfactory, the Attorney General may institute, maintain, or intervene in any suits, actions, or proceedings of any type in any court or tribunal of competent jurisdiction or before any administrative agency for the relief by way of injunction or any other temporary, preliminary, provisional, or final remedies as may be appropriate to protect the rights of the beneficiaries or to undo the consequences of failure to comply with the voting record requirements. In any action, suit, or proceeding, there may be joined as parties all persons and entities responsible for or affected by the activity.

(b) Any person or entity who brings an action pursuant to or to enforce the provisions of Section 710 may petition the court for an award of costs and reasonable attorney's fees that the court shall award if the action is successful.

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YOLO
LAVERAS
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California State Senate

STATE SENATOR

John Garamendi

CHAIRMAN, SENATE REVENUE & TAXATION COMMITTEE

COMMITTEES

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SELECT COMMITTEES
FAIRS AND RURAL ISSUES
FOREST RESOURCES
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MEMBER:
NATIONAL CONFERENCE OF STATE
LEGISLATURES (NCSL)

June 16, 1988

Mr. Bob Monks
Institutional Shareholder
Services, Inc.
3050 K Street, N.W., Ste. 300
Washington, D.C. 20007

Dear Bob:

Please review and comment on the enclosed amendments to SB 1600. The bill is set to be heard in the Assembly Judiciary Committee on August 3. I would like to receive your comments as soon as possible.

Sincerely,

Masako

MASAKO DOLAN
Senior Consultant

MD:vod
Enclosure

Amend Section 710(c) as follows (deletions are shown by strikeouts, additions by underline):

(c) Upon a reasonable written request, the person possessing the power to vote shares of stock on behalf of another, or a designated agent, shall disclose the voting record with respect to any matter involving a specified security ~~to the person on whose behalf the shares were voted.~~ <u>in accordance with the following procedures:</u>

<u>(1) Except as set forth in (2), disclosure shall be made to the beneficiary or participant making the request. The person making the disclosure may require identification sufficient to identify the person making the request as a person on whose behalf the shares were voted. A request for identification, if made, shall be reasonable, shall be made promptly and may include a request for the beneficiary's or participant's social security number.</u>

<u>(2) If the person possessing the power to vote shares on behalf of another holds that power pursuant to an agreement entered into with a party other than the beneficiary or participant making the request for disclosure, the person maintaining and disclosing the record pursuant to this section may instead make the requested disclosure to that party. The person making such disclosure shall disclose to the requesting person the identity of the party to whom the requested disclosure was made.</u>

Testimony to Commission on Economic Affairs
Anti-Takeover Legislation
Philip H. Mirvis

Very pleased to participate on this panel tonight and speak to you from a base of some experience with corporate takeovers--both good and bad ones. As an example, in 1986 and 87 I worked with W. Michael Blumenthal, then Chairman of Burroughs Corporation, following the hostile takeover of Sperry Corporation by Burroughs. This was the third largest merger in US history and, at that time, the largest unfriendly takeover.

I'm pleased to report that Blumenthal built a new company, UNISYS, on the principles of partnership and meritocracy. The best people and ideas were drawn from both companies and the new company achieved a business vitality heretofore unknown to either of them separately. The company recorded a 50% increase in eps in just one year after the merger. Yes, there were losses during the combination period. The combined company's workforce was cut by 5% through attrition, early retirement, layoffs and plant closings. Assets were sold. Yet the employment base of the combined company is now growing and, in the eyes of many analysts, UNISYS has a bright future in the computer industry.

This turned out to be a good deal--for both parties and, on balance, for most employees.

Now I'm working with Joe Henson of Prime Computer, a Massachusett's company, who led a takeover of ComputerVision. Henson, too, is committed to building a new company and is leading the combination with vision and compassion. It will result in some job loss and displacement. I'm hopeful, however, that a few years down the road people will adjudge this combination as a good one.

But I've seen some bad ones. Several years ago I worked with Marathon Oil. Mobil's unfriendly bid for Marathon Oil would have destroyed Findlay, Ohio, Marathon's HQ, and stripped the company of over 10,000 employees. Through a combination of public pressure (parades through downtown Findlay) and friendly judicial rulings (Ohio has some legislation protecting state chartered companies from unwanted sales), this bid was stopped. The market pressure was such, however, that Marathon was forced to turn to US Steel, now USX, to satisfy stockholders. No one at Marathon today is happy with that....

Nor are they happy at Graphic Controls, a Buffalo Co., also forced to find a "white knight" to thwart an unfriendly takeover bid. The company was sought by an "asset stripper"--an outfit that break up firms and sell off the pieces to the highest bidder. They were saved by a company that turned them into a "cash machine" -- lowering employment and limiting investment in R&D and capital expansion. That's often the fate of companies that have to turn to "white knights."

Now, I am a psychologist by training so I want to address right off the human toll.

First, job loss. Everyone here knows about the stresses and problems of the unemployed. Studies by David Birch show that since 1980, 2 millions jobs in Fortune 500's have been eliminated. Why? Many trace it to MADD-ness--MADD for mergers, acquisitions, divestitures, and downsizing. In this decade, fear of takeovers, as much as takeovers, mergers, and acquisitions themselves, has led companies to reduce "bodies" and forsake human and capital investments for the future.

The real losers in takeover bids are employees. A sanitizing term--RIF's for reductions in force--has arisen to "cover" the carnage of job loss during this period. I'm sure you have heard from or will hear from many experts on the plight of the involuntarily unemployed. I won't belabor the statistics on the frightful toll to their health and welfare.

I would note, however, that even the so-called survivors are touched by MADDness. In everytakeover I've known of or worked on, one or more executives died from a heart attack. On a project I'm working on now, over 20% of the executives are in a "high risk" blood pressure catagory, up from 8% prior to being taken over. In addition, I've never been through a plant closing where there wasn't an increase in somatic and psycho-somatic sympotomology--more tension headaches, backpain, ulcers, impotence, and simply loss of energy and hope.

Naturally performance, morale, and esprit de corps suffers in takeover targets. People are angry (why did it happen to us?) and go through a period of grieving. They lose their sense of security, their track record of performance, their ties to colleagues and friends. In a target, it's every man for himself. Finally, let me cite the broad costs to the commonweal. There is, for example, a frightful loss of loyalty to "the company" in the American workforce today. The prevailing logic is that only "fools" are loyal to a company because the company isn't (and can't be) loyal to them?

Certainly, we've entered an era of "free agent management" where managers come and go through a revolving door. It doesn't make any sense for them to build up their operations or invest for the future when their company is apt to be bought or sold. The implication: it only makes sense to look out for yourself.

We've also entered an era of widespread cynicism. A national survey Dr. Donald Kanter, of Boston University, and I conducted in 1983 showed that nearly 80% of the workforce believes that management can't be trusted and that companies take advantage of people if they can. I think much of this is driven by merger mania and people's concerns that management will "sell them out" if forced to and even if given a chance.

With this backdrop, then, I want to speak briefly to three questions of pertinence to this committee:

1) What do we know about the costs and benefits of mergers, acquisitions, and takeovers. Said another way, Is it worth the human toll?

2) What do we know about the differences between "good" and "bad" combinations?

3) What legislative and/or policy initiatives are needed so as to ensure people in business are free to conduct their affairs in the economic interest of "stockholders" yet forced to be accountable to various "stakeholders" including employees and the communities in which they do business.

WHEN SPEAKING TO ACADEMICIANS, POLICY MAKERS, REPRESENTATIVES OF THE MEDIA AND GOVERNMENT, I THINK IT CRUCIAL TO GET THEM INTO THE MINDSET OF CORPORATE TAKEOVERS. TO VICARIOUSLY EXPERIENCE THE IMMEDIATE IMPACT...Now its not hard anymore at ABC or NBC for them to get the picture. Here's what it would look like from your perspective.

Imagine, over the wires, reading the following story:

In a bold and unpreecndented move, the Governor of the State of Texas announced his intentions to acquire the Commonwealth of Massachusetts. The Governor, in a press conference accompanied by several Texas moneymen, his so-called Big Hat Boys, stated: The Lone Star state was built with what you might call unfriendly acquisitions in the last century. We've lived off our own assets to the present time but now feel compelled to get a hold of a little of that Massachusett's miracle for our state.

Analysts were stunned by the move. Several opined that taxpayers, both individuals and corporations, who will vote on the basis of their contributions to the commonwealth, would probably go for the proposed deal. Texas has promised to reduce taxes and streamline operations in the combined state through a massive restructuring of all three branches of government in the Commonwealth. Some layoffs and relocations are inevitable. One Texas insider noted that there was no need for two legislatures, state houses, or state governments. "Massachusetts has too God Damn many committees to get things done anyway," he added.

The move apparently caught Governor Dukakis, active on the campaign trail, by surpise. He promised to "study it." Campaign insiders point the upside benefits to Dukakis of gaining Texan's support in the upcoming election. "You gotta think over all the angles," one stated, "besides a case can be made that it's in our people's best interests."

Citizen groups formed immediately to fight the bid. Many expressed outrage at having no formal means to express their views. "The money crowd has all the votes," one citizen group leader decried. It was rumored that the legislature was meeting to consider granting golden parachutes to senior government officials. "Now you'll see who really runs the Commonwealth," one legislator noted, "and they'll be running off rich!"

There was no comment from the White House. Spokesmen stated only that the President supported any efforts to privatize public service and that this proposed takeover, while not taking Massachusetts out of public service, was certainly a move in the right direction. It was promised that a quote or two would be forthcoming ....

Costs and Benefits of Mergers:

Peter Steiner, in his book Mergers, writes: "Men differ about whether mergers are examples of the triumph or of the failings of the free-market system and the profit motive."

Mark Twain, "There are lies, damn lies, and statistics."

Basic Data:

It's dismal. Between 50 and 75% are not successful. Anybody who argues takeovers maximize shareholder's interests refers only to the fact that some make a "short term killing."

The Scorecard: An FTC study on mergers from 1970-1980. Earnings of combined firms less than earnings of two separately in 3 out of 4 cases.

Stephen Boyle and Philip Jaynes, report to FTC on conglomerate mergers, corrected for earnings trends. Profitability declined as a percentage of sales in 34 of 59 cases.

Meeks, Applied Economics dept of University of Cambridge, correcting for time frame--showed that while profitability increased 40% first year, it declined for seven years thereafter.

Robert Stich, 1974, US government analysis of 228 merger active vs. 900 other firms in same nine industries showed no difference in market performance. "There is little doubt the merger movement has been a financial failure."

Michael Lubatkin, review of mergers in the field of finance from 1970 through 1984, concludes no real gains from mergers.

Michael Fifth, The Economic Journal, concludes, any gains in profitability offset by debt and losses.

Why then?	Cash	"make vs. buy"
	Greed	"can make a killing"
	Ego	"machismo"

Two Developments in Current Wave of Mergers:

1) 3 waves -- today MEGAMergers
Mobil and Montgomery Ward 1.6B

2) Unfriendly Takeovers

Takeover terminology:
from Paul Hirsch, Pack Your Own Parachute

players:	
Pirates and Raiders	hostile companies seeking takeovers.
Big Hat Boys	Texas moneymen seeking takeovers.
aided by:	
Hired Guns	M&A specialists
Junk Bonds	High risk/high yield debt certificates
out:	
Big Game Hunting	Megamerger takeover attempts.
Bear Hug	Hardball tactics.
Ambush	Tactics in takeover attempt.
resulting in:	
Tombstones	Advertisements to investors of bid.
Wounded list	Executives who become ill during deal.
Casualties	People who are "forced out"
depending on:	
Pigeon	Vulnerable
Summer Soldier	Little resistance. or
defended by:	
Barricades	Lawsuits
Shark repellent	Protective strategies--staggered board.
Cyanide pill	Debt comes due in event of takeover.
Scorched earth	mudslinging
hinges upon:	
Golden parachutes	lucrative contracts that trigger w/sale.
White Knight	friendly company enters fray
greenmail	payoff to lead co in takeover

Language is not neutral: THIS IS WAR.

ISSUE: Wall Street interested only in WHO Wins.
Also fees ($50m in Campeau/Federated deal)

GOVERMENT: Impact on Commonweal.

Why do combinations go wrong:
Managerial Perspective--MAC Study:

Wrong Price, Wrong Partner, Wrong Period, Wrong Process

What differentiates Good Ones and Bad Ones:
Managerial Perspective--see MAC Study:

Managerial issues: review Merger Syndrome. But...Not of concern here.

What differentiates Good Ones and Bad Ones:

1) Focus on Stakeholders not just Stockholders.

Investors and stockholders are #1.
Capital markets are #2.
Customers and reputation are #3.
Managers are #4. (inverted)
Employees are #5.

All considered, all informed, all given a voice.

2) Secrecy and Deception.

SEC requires and prudence demands.
Too often -- Nothing will be changed. Then layoffs, relocations, divestitures, and so on.

People vote with feet. 50% of execs leave in one year. 75% in three (Lamalies Associates)

Alternative? Informed choice!

3) Coercion.

Absence of choice/options as to plant closings, layoffs, etc. Owner/manager decision. Union contracts require consultation.

How about required consultation with employees, community officials, and so on?

4) Handling of terminations, loss, grief....

Currently anything goes. Calculus: Loss of reputation, loyalty, goodwill. Meaningless on Wall Street.

How about required level of service provided? OSHA guidelines. A safety and health issue. Workmen's Comp. An issue of restitution. In takeover situations can we consider safety and health and restitution in public policy?

Implications for Legislation ON TAKEOVERS:

A. STAKEHOLDERS. Documents filed with FTC on restraint of trade. Information to Stockholders on proposed plans and projections. How about:

ECONOMIC AND SOCIAL IMPACT STATEMENT:

EMPLOYMENT AND IMPACT ON CURRENT EMPLOYEES.
BUSINESS PLANS RE: DIVESTITURES AND CLOSINGS.
MEMBERSHIP ON B OF DIRECTORS.
COMMUNITIES AND ENVIRONMENT CONSEQUENCES.

B. DECEPTION AND COERCION.

PERIOD OF COMMENT:

STAKEHOLDER CONSULTATION REQUIRED. APPLIES TO NEW LEGISLATION. HOW ABOUT NEW BUSINESS MOVES?

POSSIBILITY OF ARBITRATION:

MORE Arbitrators FEWER Arbitrageurs. Independent persons to hear comment from two companies, employee reps, politicans and citizens. Full Case to stockholders and stakeholders.

C. ENTITLEMENTS TO DISADVANTAGED.

REQUIREMENTS AS TO:

COMPENSATION; OUTPLACEMENT, PLANT CLOSINGS, ETC.

(GUIDELINES IF NOT REQUIRED)

COMMITMENTS FROM NEW/OLD MANAGEMENT ON MATTERS OF PERTINENCE. PUBLIC CAN JUDGE IF TRUE TO WORD.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
BOSTON REGIONAL OFFICE

Room 1184
10 Causeway Street
Boston, Massachusetts 02222-1073
(617) 565-7240

September 2, 1988

The Honorable Joseph D. Alviani
Secretary
Executive Office of Economic Affairs
One Ashburton Place--Room 2101
Boston, MA 02108

Dear Mr. Secretary:

The staff of the Federal Trade Commission is pleased to respond to your letter of invitation of August 2, 1988, to provide comments to the Commission to Review the Massachusetts Anti-Takeover Laws on the role of the state in regulating corporate takeovers. */ Chapters 110C, 110D, and 110E of the Massachusetts General Laws currently regulate corporate takeovers. The principal provisions of Chapter 110C contain disclosure requirements with which offerors in takeover bids must comply, prescribe a minimum period for which such bids must remain open, and require that all shareholders who tender their shares receive the benefit of any increases in the offer price for the target firm's shares. Chapter 110D regulates "control share" acquisitions of certain companies incorporated in Massachusetts by prohibiting bidders for corporate control from voting "control shares" unless a majority of "disinterested" shareholders has voted to authorize the exercise of that right. 1/ Chapter 110E regulates control share acquisitions of certain companies incorporated outside of Massachusetts. 2/

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*/ These comments are the views of the staffs of the Bureau of Competition and of the Boston Regional Office of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner.

1/ Chapter 110D is similar to an Indiana "control share" statute whose constitutionality was recently upheld by the Supreme Court in CTS Corp. v. Dynamics Corp., 107 S. Ct. 1637 (1987). The Court held that the Indiana law was not preempted by the federal Williams Act, 15 U.S.C. § 78m(d)-(e), 78n(d)-(f), or Securities and Exchange Commission regulations promulgated thereunder, and did not unconstitutionally interfere with interstate commerce.

2/ Chapter 110E differs from the Indiana statute that was upheld by the Supreme Court in that it also applies to
(continued...)

We believe that Chapters 110D and 110E are likely to deter takeovers that may increase economic welfare. If the Commission nevertheless decides to recommend that those provisions be retained, we suggest that it consider recommending that Chapters 110D and 110E be made applicable solely to corporations that affirmatively elect to be covered by them through amendments to the corporations' articles of organization. 3/ An affirmative "opting-in" provision would enable the shareholders of each corporation to determine whether restraints on the transfer of corporate control are in the interests of the corporation. With respect to Chapter 110C, we believe that certain waiting periods imposed by that chapter have the potential of delaying takeover bids beyond the waiting period already mandated by federal law. The result may be to deter takeovers.

A. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Pursuant to this mandate, the Commission seeks to identify restrictions that impede competition or increase costs without offering countervailing benefits to consumers. Our efforts have included providing comments to federal, state, and local legislatures and administrative agencies on matters that raise issues of competition or consumer protection policy.

The Commission has substantial experience in the area of mergers and acquisitions. The Commission enforces section 7 of the Clayton Act, 15 U.S.C. § 18, which prohibits acquisitions of corporate assets or securities that may substantially lessen competition or tend to create a monopoly. Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a, the Commission reviews proposed acquisitions of corporate securities, including tender offers, to determine whether they violate the antitrust laws.

The Commission's staff has addressed issues related to the market for corporate control through scholarly studies and com-

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2/(...continued)
nonresident corporations. We do not address here the constitutional issues raised by that feature of the chapter. See CTS Corp. v. Dynamics Corp., 107 S. Ct. at 1651-52; Edgar v. Mite, 457 U.S. 624, 645-46 (1982).

3/ Chapter 110E contains an opt-in provision which, because it allows opting in through an amendment to corporate by-laws, does not necessarily require a shareholder vote.

ments to state governments. Last year, the Commission's Bureau of Economics published a study on the effects of takeover legislation enacted by New York in 1985. 4/ In the past two years, the Commission's staff provided comments on corporate control legislation to the governor of New York and to the New Jersey, Delaware, and Texas legislatures.

B. Effect of Takeovers on Economic Welfare

The corporate takeover is a mechanism for transferring control of corporate assets. The transfer of corporate control can serve a number of economic functions, such as facilitating the redeployment of corporate assets to more efficient uses and improving corporate management. Although not every takeover ultimately produces such benefits, we believe that takeovers in the aggregate are likely to enhance economic efficiency.

Some studies suggest that management-opposed corporate acquisitions are most commonly carried out when outside bidders have an opportunity to improve the performance and thereby increase the value of target corporations. 5/ Such bidders pay substantial premiums over the pre-offer market price of the shares of target corporations because they believe that the corporations will be worth more under their control. 6/

There are a number of sources for the potential gain in an acquired firm's performance. In some cases, bidders are able to improve the management of the target firm. In other cases, bidders may be able to combine firms with complementary strengths, integrating production or distribution channels, eliminating duplicative functions, or facilitating mutually beneficial technology transfers. Takeovers may also permit firms

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4/ L. Schumann, State Regulation of Takeovers and Shareholder Wealth: The Effects of New York's 1985 Takeover Statutes (Federal Trade Commission, Bureau of Economics, 1987).

5/ See Bradley, Desai & Kim, The Rationale Behind Interfirm Tender Offers: Information or Synergy, 11 J. Fin. Econ. 183 (1983); Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819 (1981); Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981).

6/ There is evidence that share prices of most target companies significantly underperform the market in the pre-offer period. See Gilson, supra note 5, at 852-53, and sources cited therein.

to shift corporate assets to more efficient uses by selling or changing the use of underperforming facilities.

The transfer of corporate control in such circumstances is likely to benefit shareholders, employees, and the economy as a whole, as well as the successful bidder. Shareholders benefit in two ways. First, because bidders for corporate control offer substantial premiums over the pre-offer market price of corporate shares, target company shareholders enjoy rapid appreciation of the value of their shares. Second, the threat of takeovers may motivate incumbent corporate managers to improve corporate performance. Employees benefit from enhanced corporate efficiency and the accompanying gains in corporate competitiveness. 7/ The economy can benefit both from the transfer of corporate control to more efficient management and from the incentives that takeovers create for improved managerial performance.

Numerous scholarly studies have concluded that takeovers, on average, lead to an increase in the stock market's valuation of both the acquired and the acquiring firms. According to a recent study, share prices of acquired firms increase by an average of 53.4 percent. 8/ Different studies report that the share prices of acquiring firms have tended in the past to increase by smaller amounts, ranging from 2 percent to approximately 7 percent, 9/ although in this decade acquirers may have experienced no gains at all. 10/ Even if the acquiring company's

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7/ Profitable firms provide the best opportunities for wage growth, new employment, and the fulfillment of pension and other contractual obligations to workers.

8/ Office of the Chief Economist, Securities and Exchange Commission, The Economics of Any-or-All, Partial, and Two-Tier Tender Offers, Table 4A (1985).

9/ Those findings are summarized in Jensen & Ruback, The Market for Corporate Control: The Scientific Evidence, 11 J. Fin. Econ. 5, 11 (Table 3), 16-22 (1983). See also Jarrell & Bradley, The Economic Effects of Federal and State Regulations of Cash Tender Offers, 23 J. Law Econ. 371, 393-95 (1980); Council of Economic Advisers, Economic Report of the President 197 (1985).

10/ See Jarrell, Brickley & Netter, The Market for Corporate Control: The Empirical Evidence Since 1980, 2 J. Econ. Persp. 49 (1988). A recent study of the effects on the stock prices of the acquiring firms in 78 hostile takeovers between 1976 and 1981 concluded that those firms lost 42 percent of their value over the three years following their acquisitions. Magenheim &
(continued...)

shares experience no gains, these studies suggest that the market values the combination of the acquirer and the target company more highly than the individual firms that would exist in the absence of a takeover. 11/

These studies measure the stock market performance of the companies involved during short periods of time surrounding takeover bids. They may be viewed as offering the stock market's long-term valuation of takeovers based on the information available at the time the takeover is announced. These valuations may change over time as more information is gained about the likely effects of the takeover. Thus, these studies serve only as indirect estimates of long-term performance. Economic scholars largely agree, however, that the increases in company valuations reported by these studies represent efficiency gains. See note 13, infra. Of course, sharp fluctuations in market values, such as those experienced during last year's stock market crash, may require a cautious approach to long term conclusions. Some scholars have also questioned the overall effects of mergers and unsolicited takeovers on economic efficiency. 12/

A substantial body of economic and legal literature supports the view that these increases in the stock market's valuation of

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10/(...continued)
Mueller, Are Acquiring-Firm Shareholders Better Off After An Acquisition?, in Knights, Raiders, and Targets 171 (J. Coffee, L. Lowenstein & S. Rose-Ackerman ed. 1988). That study has been criticized for using methodology that significantly overstates the losses of the acquiring firms' value. See Bradley & Jarrell, Comment, id. at 254. Bradley and Jarrell, using the data from the Magenheim-Mueller study and a different methodology, concluded that the acquiring firms' three year losses were actually statistically insignificant. Significantly, they also note that even when "acquiring firms suffer capital losses, the gains to targets outweigh these losses, and the net effect is a significant increase in the value of the combined assets." Id. at 256.

11/ Similarly, share prices of both bidding and target firms usually decline after unsuccessful takeover bids to below the pre-offer level. Bradley, Desai & Kim, supra note 5, at 189-204; Jensen & Ruback, supra note 9, at 8.

12/ See Ravenscraft & Scherer, The Long-Run Performance of Mergers and Takeovers, in Public Policy Toward Corporate Takeovers 34 (M. Weidenbaum & K. Chilton ed. 1988); Herman & Lowenstein, The Efficiency Effects of Hostile Takeovers, in Knights, Raiders, and Targets, supra note 10, at 211.

firms following a takeover represent efficiency gains, and the creation of new wealth, attributable solely to the takeover. 13/ Participants in the stock market are not likely to bid up the price of equity securities involved in takeovers unless prior takeovers, on average, produced such gains. Other studies quarrel with these conclusions, but many of these studies contain methodological errors. 14/ A major scholarly study that relied on accounting data took issue with the conclusions of the stock market studies and concluded that takeovers neither improved nor degraded the performance of the target firms. 15/

13/ See, e.g., Economic Report of the President, supra note 9, at 187-216; Jensen & Ruback, supra note 9; Jarrell, Brickley & Netter, supra note 10; Bradley, Desai & Kim, supra note 5; Gilson, supra note 5; Easterbrook & Fischel, supra note 5; Easterbrook & Jarrell, Do Targets Benefit from Defeating Tender Offers, 59 N.Y.U. L. Rev. 277 (1984); Pound, Lehn & Jarrell, Are Takeovers Hostile to Economic Performance?, Regulation, Sept.-Oct. 1986, 25.

14/ For example, Weidenbaum & Vogt, Takeovers and Stockholders: Winners and Losers, 19 Cal. Mgmt. Rev. 157 (1987), incorrectly relied on evidence concerning negotiated mergers to conclude that management-opposed takeovers reduce efficiency. When the evidence of management-opposed takeovers reviewed by the authors is examined separately, it supports the conclusion that takeovers enhance efficiency. Similarly, Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101 (1979), offered evidence purporting to show that stockholders benefited from management resistance that resulted in the defeat of takeover bids. Lipton's evidence showed that the share prices of some firms that had defeated takeover bids increased above the tender offer price a number of years later. His study did not compare these share price movements to the overall market's movement during the same period. More systematic studies, which examine abnormal returns on shares of takeover targets compared to overall market trends, show that stockholders incur significant losses from the defeat of takeover bids. See generally Easterbrook & Jarrell, supra note 12, at 282-84.

15/ D. Ravenscraft & F. Scherer, Mergers, Sell-Offs, and Economic Efficiency 101-03 (1987). The authors used accounting data to measure economic rates of return. This methodology is controversial because profits revealed by such data are subject to wide variations resulting from the use of divergent accounting conventions by different firms. See generally Benston, The Validity of Profits-Structure Studies with Particular Reference to the FTC's Line of Business Data, 75 Am. Econ. Rev. 37 (1985); Fisher & McGowan, On the Misuse of Accounting Rates of Return to

(continued...)

Accordingly, no scholarly consensus on the economic effects of takeovers supports changes in the law to make management-opposed takeovers more costly and difficult. On the contrary, we believe that the preponderance of scholarly opinion on the subject supports the conclusion that management-opposed takeovers produce economic benefits, and that new restrictions on takeovers are likely to undermine economic efficiency.

C. Asserted Disadvantages of Takeover Activity

Purported disadvantages of takeover activity are often asserted to justify restraining corporate acquisitions. Although we know of no empirical research to substantiate these disadvantages, they are often cited by incumbent managers and other takeover critics in testimony before Congressional committees and in articles in the general press. In the absence of persuasive substantiating evidence, these claims do not support the enactment of curbs on takeover activity.

Some takeover critics claim, for example, that acquirers often take over well-managed corporations, oust good management, and reduce corporate efficiency by installing less capable management teams. This, indeed, may happen in some cases. Corporate acquirers, like all other businesspersons, may make mistakes. This possibility, however, does not justify controls on takeover activity any more than the possibility of poor investments in plant or equipment justifies government controls on investment decisions made by corporate managers. In a market economy, investment decisions generally are best left to investors, who stand to profit from correct decisions and lose from poor ones. The critical fact is that takeover activity, in the aggregate, has not been demonstrated to have adverse effects and in fact appears to benefit society. Because the evidence suggests that the benefits of takeovers outweigh their costs, restricting takeovers in the hope of preventing unwise investments is likely to harm societal welfare.

15/(...continued)
Infer Monopoly Profits, 73 Am. Econ. Rev. 82 (1983). In addition, because of constraints on the availability of data, the study focuses largely on conglomerate mergers, and not management-opposed takeovers. See Ravenscraft & Scherer, supra, at 22. As the authors observe, however, the incidence of horizontal merger activity has increased markedly in this decade, and "[t]he shift toward large horizontal mergers is more difficult to evaluate solely on the basis of our research." Id. at 219.

It also has been argued that management-opposed takeovers result disproportionately in facility closings and lay-offs, which impose great social costs on individuals and communities in which plants are located. But factual support for the position that takeovers in fact lead to plant closings and lay-offs that would not have occurred otherwise is, at best, scanty. 16/ Indeed, it is difficult to assess whether or not closings or lay-offs that occur after takeovers would have been carried out by the target's management in any event to keep the firm competitive. Moreover, most economic changes that increase efficiency -- and thereby increase aggregate societal wealth -- create dislocations that reduce the welfare of some individuals. 17/ Virtually every major technological advance renders an earlier technology obsolete and thus may harm firms and individuals dependent on the earlier technologies.

Finally, it is argued that takeovers force corporate managers to focus on short term profits and forego long term investments. The evidence shows, however, that foregoing long term investment makes companies more, not less, vulnerable to takeovers. Takeover targets tend to have below-average research

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16/ See Jensen, Takeovers: Folklore and Science, Harv. Bus. Rev. Nov.-Dec. 1984, at 114 ; cf. American Enterprise Institute, Proposals Affecting Corporate Takeovers 31 (1985) (citing finding that "very few jobs were affected" by 6,000 corporate acquisitions in 1970s). The AFL-CIO estimates that a total of 80,000 jobs of members of its affiliated unions have been lost as a "result of corporate restructuring" in recent years. Hostile Takeovers, Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 100th Cong., 1st Sess. 262 (1987) (statement of Thomas R. Donahue) (hereinafter "Hearings on Hostile Takeovers"). Even assuming that this estimate, for which the time frame is unspecified but presumably spans a number of years, is correct, it is difficult to assess how many of those jobs would have been abolished in any event to improve the competitiveness of the affected companies. To put the figure in perspective, a total of 5.1 million workers lost their jobs because of plant closings or efficiency measures in the years 1979-1983. Bureau of Labor Statistics, Monthly Labor Review (June 1985).

17/ It would seem preferable for government to respond to these inevitable economic dislocations by initiating effective remedial measures to assist displaced individuals rather than severely restricting economic activity that benefits society. Such measures may include, for example, programs to retrain workers displaced from declining industries.

and development budgets, showing a lesser commitment to long term investments than the average firm. 18/

D. Effects of the Massachusetts Takeover Statutes

Chapters 110D and 110E of the Massachusetts General Laws regulate "control share acquisitions", which they define as the acquisition of shares that, but for the statutes' requirements, when added to the acquiring person's preexisting shares, would entitle the acquirer to exercise voting power within one of three ranges: one-fifth to one-third, one-third to one-half, or a majority of all voting power. 19/ Chapter 110D applies to control share acquisitions of certain companies incorporated in Massachusetts, while Chapter 110E applies to control share acquisitions of certain companies incorporated outside of Massachusetts. Both chapters provide that a person who acquires "control shares" may exercise the right to vote those shares only if the holders of a majority of the corporation's voting shares, other than "interested shares," vote to grant the acquirer that right. The term "interested shares" is defined as shares owned or controlled by the acquirer, by the target corporation's officers, or by the target corporation's inside directors (corporate directors who are employed by the corporation). Shares owned by outside directors are not considered "interested."

Under the provisions of Chapters 110D and 110E, an acquirer of "control shares" may demand a special shareholder meeting "for the purpose of considering whether voting rights shall be authorized for the shares acquired or to be acquired in the control share acquisition." If the request is accompanied by "an undertaking to pay the corporation's reasonable expenses in connection with the special meeting", the corporation must hold such a meeting within 50 days of the date of the demand. If no such demand is made, voting rights of control shares must be

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18/ This proposition is supported by a recent empirical study of the investment patterns of takeover targets. The study, which examined all 217 takeover targets that were acquired between 1980 and 1984, found that takeover targets had below average ratios of (i) research and development expenditures to total expenditures and (ii) capital investment to earnings. Office of the Chief Economist, Securities and Exchange Commission, Institutional Ownership, Tender Offers, and Long-Term Investment 8-10 (1985).

19/ In practical terms, for most purposes of Chapters 110D and 110E, any shares whose acquisition would give the acquirer more than 20 percent of the corporation's voting power are "control shares."

considered at the next annual or special meeting of the corporation. Section 7 of Chapter 110D provides that if "disinterested" shareholders vote to confer voting rights upon "control shares," dissenting shareholders, unless otherwise provided in the corporation's by-laws or articles of organization, gain the right to demand payment for their shares and an appraisal of their value. The amount received by dissenting shareholders may not be less than the highest price per share paid by the person who made the control share acquisition.

Chapters 110D and 110E impose a number of restrictions on the ability of potential acquirers to obtain control of target companies. First, a potential acquirer who has purchased a majority of a corporation's voting shares is not assured of obtaining actual control of the firm. Rather, the acquirer is required to wager that the so-called "disinterested" shareholders will agree to grant it the voting power that ordinarily passes with the ownership of shares. In the event that the "disinterested" shareholders do not so agree, the value of the acquired shares is likely to decline significantly. This restriction may discourage many potential acquirers from even attempting takeover bids. Moreover, the statutes likely exact from acquirers a penalty that increases directly with the size of their investment in the target firm; the larger the acquirer's investment in a firm, the less likely it would be to gain control, since the remaining "disinterested" shares may be in the hands of entities friendly to management, such as outside directors and employee stock ownership plans.

Second, although an acquirer may demand a special shareholder meeting to consider the voting rights to be accorded "control shares," the special meeting can be delayed for as much as 50 days after it is requested. At a minimum, this requirement will add three weeks to the 20-business day minimum tender offer period that bidders now face under federal law. See 17 C.F.R. § 240.14(e)(1). During that additional period, potential acquirers must bear a significant financial burden. To avoid the risk of paying a premium price for what ultimately will be non-voting shares, bidders will have to extend the duration of tender offers to at least the 50-day waiting period imposed by the statute. During that period, they must bear the cost of capital for financing the acquisition, though they have no assurance that the acquisition will ultimately be made. By so increasing the costs of acquisition efforts, the provisions of Chapters 110D and 110E likely reduce their frequency. 20/

20/ Alternatively, bidders could make conditional tender offers, pursuant to which acceptance of tendered shares is contingent on (continued...)

Chapter 110C contains several provisions regulating takeover bids that are similar to those in the federal Williams Act and the regulations promulgated thereunder. Sections 6 and 7 of that chapter, however, also contain certain provisions that, like Chapters 110D and 110E, have the potential for extending the minimum time period for which offers must remain open significantly beyond the 20 days required by federal law. 21/ Section 6 provides that the state secretary may take as long as 45 days from the commencement of an offer to adjudicate whether the takeover bid is in compliance with the disclosure and other requirements of Chapter 110C. Section 7 requires that a takeover bid remain open for at least 15 days after it is deemed to be in compliance with the chapter. Thus, the effect of sections 6 and 7 is that an offeror faces the possibility of having to keep the offer open for up to 60 days, which is more than four weeks longer than the 20-business day requirement of the Williams Act. The result, like that of the 50-day waiting periods imposed by Chapters 110D and 110E, will likely be to increase the costs and uncertainty of acquisition efforts.

The overall effect of statutes that increase both the cost and uncertainty of takeover bids is likely to be a reduction in

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20/(...continued)
the subsequent approval of voting rights for those shares. Because the 50-day waiting period in the proposed legislation exceeds the minimum offering period under federal law by three weeks, however, incumbent management would gain an additional three week period between the conditional acceptance and the shareholder vote in which to adopt defensive measures to thwart the tender offer, such as the sale of corporate assets to another firm. Under the "business judgment rule," such actions may be insulated from judicial scrutiny. See 3A W. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 1041.1 (rev. perm. ed. 1986). In addition, a conditional offer is less likely to be successful than an unconditional one, since some shareholders will not wish to tie up their shares for the period during which the voting right issue remains unsettled.

21/ Section 3 of Chapter 110C provides that prospective takeover bid acquirers who fail to disclose their intent to gain control of the target company before acquiring five percent of its stock may not make a takeover bid for that target until one year after the failure to disclose. Since the United States Court of Appeals for the First Circuit recently upheld a lower court injunction against the enforcement of that section on the grounds that it likely is both unconstitutional and preempted by the Williams Act, we do not discuss it here. Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988).

the number of tender offers and the diminution of the ability of shareholders to exercise their rights as owners to transfer control of corporations. 22/

F. Empirical Evidence on Effect of Anti-Takeover Legislation

Three recent empirical studies concerning the effect of anti-takeover legislation have concluded that anti-takeover laws harm shareholders and undermine economic efficiency. A recent empirical study by the Commission's Bureau of Economics analyzed the extent of the economic harm caused by a New York statute 23/ restricting "business combinations." 24/ The study found that the announcement by New York's governor of the proposed legislation that ultimately became the New York law resulted in a statistically significant decline in the average value of shares of New York corporations. The decline was equal to approximately one percent of the value of the shares, or $1.2 billion. 25/ As the study noted in conclusion:

> [D]espite the political rhetoric advocating the regulation of takeovers on behalf of shareholders, the evidence . . . indicates that this very strong statute does not protect shareholders; rather, the law protects managers at the expense of shareholders. . . . [In addition, the statute] may promote the inefficient management of society's assets by lessening the ability of capital markets to efficiently reallocate assets. Consequently, the real cost of the goods and services produced by the firms affected by [the statute] may increase, injuring consumers as well as shareholders. 26/

22/ See generally Easterbrook & Fischel, supra note 5.

23/ New York Bus. Corp. Law § 912.

24/ Schumann, supra note 4. "Business combination" statutes restrict the ability of acquiring firms to merge or engage in other specified business activity with unsolicited takeover targets for a specified period of time following the acquisition of target company shares.

25/ Id. at 41, 46-47. Continuing research by the same author suggests that the decline in the value of New York corporations caused by the enactment of the legislation may have been significantly greater than reported in his original paper. Measured over the entire 205-day course of the legislative process, the decline was 9.7 percent, net of market. L. Schumann, State Regulation of Takeovers and Shareholder Wealth: The Case of New York's 1985 Takeover Statutes (mimeo April 1988).

26/ Schumann, supra note 4, at 47.

Another study, conducted by the Office of the Chief Economist of the Securities and Exchange Commission, also concludes that anti-takeover legislation is harmful to the interests of shareholders. The study examined the effects of a recent Ohio law that, among other things, authorized corporate directors to consider the interests of persons other than the shareholders in assessing takeover bids. 27/ The SEC study found that the enactment of the Ohio law caused an immediate two percent decline in the equity value of corporations insulated from takeovers by the Ohio law. Finally, a recent study on the effects of Indiana's anti-takeover statute, which contains a "control share" provision similar to those in Chapters 110D and 110E, found that the enactment of Indiana's law caused a 4.2 to 6.1 percent decline in the value of shares of Indiana corporations. 28/

G. Consideration of an "Opting-In" Mechanism

If the Commission decides to recommend the retention of Chapters 110D and 110E despite the concerns discussed above, we suggest that those control share provisions be modified to make them applicable only to corporations whose shareholders affirmatively elect to be covered by them through amendments to the corporations' articles of organization. Chapter 110D currently applies to certain domestic corporations that do not "opt out" by an amendment to their articles of organization or by-laws. Chapter 110E applies to certain nonresident corporations that opt into its provisions by amendments to their by-laws or charters. To the extent that Chapters 110D and 110E are motivated by a concern for shareholders, their purposes would be better served by a requirement that shareholders approve a decision to opt into any coverage by them. Corporate by-laws generally may be amended by the board of directors without the approval of the shareholders. 29/ The votes of directors to amend the by-laws to opt into coverage by control share restrictions may be influenced by the directors' loyalty to

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27/ Office of the Chief Economist, Securities and Exchange Commission, Shareholder Wealth Effects of Ohio Legislation Affecting Takeovers (1987). The Ohio law is codified in Ohio Rev. Code Ann. § 1701.01 et seq. (Page 1986 supp.).

28/ Sidak & Woodward, Corporate Takeovers, The Commerce Clause, and the Efficient Anonymity of Shareholders (mimeo March 1987). The 4.2 percent decline represents a portfolio in which equal weight is given to all Indiana firms. The 6.1 decline represents a value-weighted portfolio.

29/ See M.G.L. c. 156B § 17.

existing management, whose jobs may be threatened by a takeover. 30/ The result may be to discourage takeovers that would benefit the shareholders. Therefore, we recommend that a corporation's decision to opt into the statutory schemes of Chapters 110D and 110E be made solely through a shareholder vote amending the articles of organization.

Conclusion

On the whole, we believe that vigorous takeover activity enhances economic efficiency and thus benefits consumers, workers, and shareholders. We believe that the state's takeover statutes are likely to impede many of the beneficial consequences of takeovers without offering countervailing benefits. The Commission therefore may wish to consider whether those statutes unduly interfere with the market for corporate control to the detriment of the economy and consumer welfare generally.

Sincerely,

Phoebe D. Morse

Phoebe D. Morse
Regional Director

30/ Indeed, the senior managers whose jobs may be most threatened by a takeover often sit on their corporation's board of directors.

THE DELAWARE TAKEOVER STATUTE: COMMENTS TO THE MASSACHUSETTS COUNCIL OF ECONOMIC AFFAIRS

by

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"[A] deliberately and sensibly weak" law.
- Professor John Coffee, Jr.

"[F]urther tilt[s] the playing field in favor of raiders."
- Martin Lipton

"[S]ound[s] the death knell" for hostile takeovers.
- T. Boone Pickens

"[A]n exquisitely crafted legislative response to a variety of perceived problems."
-BNS Inc. v. Koppers Co., Inc., Civ. No. 88-130-MMS (D. Del. April 1, 1988), slip op at 35.

That Section 203 of the Delaware General Corporation Law (the "DGCL"), 8 Del. C. §203, enacted February 2, 1988, elicits such varied responses is not surprising. They simply reflect a takeover law that carefully and deliberately balances the competing interests of the acquired and the acquiror.

THE PURPOSES BEHIND SECTION 203

Prior to 1967, cash-out mergers were not permitted under the DGCL. Among the substantial revisions made to the DGCL in 1967 was to permit stockholders to be cashed out in a merger approved by 2/3 of the stockholders. Two years later, in 1969, a further amendment lowered the required vote to a simple majority. Thus, after 1969, a bare majority stockholder had the power both to replace the board of directors and unilaterally to cash out the minority in a merger.

This ability to eliminate minority stockholders eventually led to the two-tiered tender offer, and created the so-called "prisoners dilemma" of minority stockholders who, having no negotiating strength, could be coerced into tendering into the front-end tender offer for fear of being cashed out for less in a second step merger. As financing techniques became more sophisticated, an acquiror could purchase 50.1% of the outstanding stock and obtain financing to squeeze out immediately the remaining 49.9%. The acquiror could then deal with the acquired assets at their full value, thereby permitting the acquiror to realize the full value of the corporation's assets to the detriment of the former stockholders and without paying a control premium. Corporations, if not stockholders, came to fear the coercive, two-tiered, highly leveraged takeover.

Of equal concern in the takeover context is the disparity between market premiums paid in tender offers and the inherent value of a corporation's assets. The spread between the offer price in a tender offer and the inherent value of assets is frequently substantial. Although stockholders benefit from coercive takeovers by receiving a premium over current market value, they frequently suffer a loss to the extent that they do not realize the inherent value of their stock. Such values would more likely be realized in an arms length transaction between a willing seller and a willing buyer, each possessing equal negotiating strength.

The objectives in adopting Section 203 of the DGCL were thus fourfold:

1. To protect stockholders from the harmful effects of coercive, two-tiered, highly leveraged takeovers;

2. To foster fully priced offers that allow stockholders to realize the long term or inherent value instead of a mere premium over market;

3. To restore the board of directors to the position of representative of the stockholders and provide stockholders an opportunity to negotiate through their board of directors; and

4. To compensate for the imbalance arising from the power granted to majority stockholders under the DGCL to cash out the minority.

DEVELOPMENT OF SECTION 203

Delaware was relatively cautious in adopting a second-generation takeover statute. Existing models were carefully studied in connection with drafting the statute.

Control Share Acquisition Statutes

Control share acquisition statutes, such as the Indiana statute upheld by the United States Supreme Court in CTS Corp. v. Dynamics Corp. of America, 107 Supr. Ct. 1637 (1987), typically operate to prevent an acquiror from either purchasing a control block of stock or voting the control block unless a majority of the disinterested stockholders vote to allow it to do so. Such statutes are intended to allow stockholders to make group decisions as opposed to individual decisions regarding the desirability of the proposed takeover.

Delaware studied and, for a variety of reasons, rejected the control share acquisition model. First, Delaware was uncertain of the actual effect of such a statute. With both the bidder and management excluded from the vote, it appeared that the vote would almost certainly favor a shift in control. Institutions and arbitragers, who could acquire shares before the record date for the stockholders' meeting or purchase shares with proxies attached, would almost certainly favor the acquiror. Second,

the existence of such a stockholder vote might have an adverse impact on the adoption by the board of directors of other defensive measures in response to the takeover attempt. Third, the fifty-day waiting period did not seem an effective curb on highly leveraged transactions in light of contemporary financing techniques. Fourth, such a statute made it easy and inexpensive to put a company into play, and therefore might encourage acquirors to do so. Fifth, if "one share/one vote" proposals by Congress or the SEC were put into effect, the diminishment of voting rights under such a statute might be constitutionally inferred.

Fair Price Laws

Fair price laws were also considered. Such laws are designed to protect stockholders who have not entered into a successful tender offer from being squeezed out for an inadequate consideration. Full price statutes usually require prior board approval for the squeeze out transaction and a super majority vote of minority stockholders or satisfaction of certain fair price criteria to ensure that the second step consideration equals that paid in the first step of the acquisition.

Many companies already have fair price charter provisions, and it seemed that most corporations could obtain the necessary stockholder vote to implement such provisions. Further, it appeared that fair price provisions should be suited to individual corporate circumstances. There was also

a concern over the fairness of such statutes to the majority stockholder, particulary after the passage of time, when changes in the national economy might make it unfair or prohibitately expensive to eliminate minority stockholders. Finally, such statutes principally protect the minority after the takeover. There is no protection against an inadequate offer.

Control Share Cash-Out Laws

Control share cash-out laws, which typically permit minority stockholders to sell their shares to the acquiror at an appraised fair value, were also considered and rejected. Again, no protection would be afforded to stockholders except after the fact, and an appraisal proceeding seemed likely to be of marginal benefit to minority stockholders in light of the delays typically encountered in prosecuting such actions.

Business Combination Moratorium Statutes

Existing business combination moratorium statutes, such as that adopted by New York, were examined and also rejected, although they served as the basic model for the statute ultimately adopted. Existing models seemed too harsh, and appeared designed to stop takeovers entirely. The five-year delay in effecting any business combination, with no provisions for avoiding the prohibition, did not seem to balance adequately the interests of the acquiror against those of the company being acquired and its stockholders.

Other Proposed Models

Delaware briefly considered and rejected two other alternatives. One was an excess share statute, which would have prohibited a person who acquired more than 10% of the voting stock of a corporation without prior board approval from voting more than 10% for a period of three years. After two years, the acquiror could demand a stockholder vote on whether he should be permitted to vote all of his shares, and if denied full voting power, could require the corporation to repurchase his stock. A second proposal would have permitted a corporation, at the discretion of its board of directors, to redeem shares in excess of a specified percentage at the lower of the price paid by the acquiror for such shares or the fair market value of such shares. That proposal was rejected primarily because it exposed directors to potential liability and raised constitutional problems with the taking of property.

Thus, Delaware ultimately adopted a business combination moratorium statute patterned loosely after the New York model, but with substantial variations designed to achieve a balance between the competing interests involved in the takeover context.

The 85 Percent Threshold

The discussion of draft of Section 203 provided that no acquiror could avoid the three-year moratorium by acquiring 90 percent or more of the target's stock. That

provision was criticized by some as having created a "barn-door size exception." Others, however argued that the 90 percent mark was unattainable and the exception was, therefore, a mere illusion.

The 90 percent threshold was also faulted because critics feared that it would encourage management to form a "blocking coalition" of 10 percent of the stock over which it exercised either direct or indirect control.

A third concern involved the number of stockholders who simply fail to respond to a tender offer. Such stockholders, it was argued, are not opposed to the offer, they are simply non-responsive.

In response, Section 203 was revised by lowering the threshold to 85 percent and by carving out from that 85 percent those shares owned, directly or indirectly, by director-officers and by certain employee stock plans. Shares held by outside directors were not excluded. Such an exclusion would be contrary to the existing legal presumption that such directors will act in the best interests of the company and its stockholders and might discourage significant stockholders from seeking representation on the board of directors. The exclusion from the calculation of the 85 percent threshold of shares controlled or deemed controlled by insiders inhibits the creation of a blocking coalition. As the number of shares held or controlled by the insiders increases, the percentage of stock necessary for the acquiror

to avoid the three-year moratorium decreases. Thus, for example, if insiders hold no stock, the acquiror must obtain 85 percent of the stock outstanding, but if insiders hold 10 percent of the stock, then the acquiror must obtain only 75.5 percent of the total stock outstanding (i.e., 85 percent of the 90 percent not held by insiders). Available data suggests that the 85 percent mark is not an unattainable figure.

Opt-Out Versus Opt-In

From the outset, there had been concern within the Council of the Corporation Law Section over whether Section 203 should apply automatically with a right to opt out of the statute's protection or whether the statute should provide that corporations elect the statute's protection through a charter or bylaw amendment adopted by stockholders. many comment letter received by the council raised the issue, and it was a frequent topic in the testimony before the Delaware Senate and House Judiciary Committees. Pointing to Delaware's recently adopted statute allowing a majority of a corporation's stockholders to approve a charter provision limiting director liability for certain breaches of fiduciary duty. Opt-out opponents argued that Section 203 should be an "opt-in" instead of an "opt-out" provision. Some felt the changes implicit in the proposed anti-takeover law should require the concurrence of a majority of the corporation's stockholders. An opt-out statute might change a critical

assumption upon which stockholders decide to make their investment and should therefore, under principals of equity and logic, be subject to the consent of the majority of stockholders.

The bar association and the legislature did not adopt this proposal for several reasons. First, former Section 203, which the present section replaces, was an "opt-out" statute. Second, corporations would shoulder an unfair burden if they were required to submit the issue to their stockholders, because to seek such a vote would constitute an invitation to explore the proponent's vulnerability to a takeover. Third, the other 27 states that had adopted such statutes had either an opt-out statute or no such provision at all. Finally, if Section 203 was proposed as an opt-in statute, stockholders would not, as a practical matter, be allowed to decide the question because a corporation would be much more likely to pursue a reincorporation merger out of Delaware (which requires the same vote) to some state with opt-out legislation already in place.

SECTION 203 IN OPERATION

Section 203 does not prohibit takeovers. Rather, it contains a variety of methods to acquire a corporation, even without the consent of the corporation's board of directors. Such mechanisms were drafted to encourage fully priced, any and all offers.

Generally, Section 203 provides that if a person acquires 15% or more of the voting stock of a Delaware corporation without the prior approval of the board of directors of that corporation, he becomes an interested stockholder and may not engage in any business combination with the corporation for a period of three years. After the three years expire, he is free to engage in any business combination whatsoever. The term "business combination" is defined to included such transactions as mergers, sales of assets, and transfers of stock. All such transactions involve self dealing between the controlling stockholder and the corporation. Transactions with unaffiliated parties are not affected.

In order to assure a balance between the interests of the acquiror and those of the acquired company and its stockholder, Section 203 provides seven means of avoiding the business combination prohibition:

1. The board of directors may approve the acquisition of the stock or the proposed business combination prior to the time that a person becomes an interested stockholder.

2. A person who acquires 85% of the voting stock of the corporation in the transaction in which he becomes an interested stockholder is exempt from the statute. For purposes of determining the 85% threshold, stock owned by

individuals who are both officers and directors and stock owned by certain employee stock plans are excluded.

3. The business combination may be approved by a 2/3 vote of outstanding voting stock not owned by the interested stockholder.

4. If directors who are in office prior to a person becoming an interested stockholder approve a control transaction with a person who is not an interested stockholder, any existing interested stockholder and any other person is free to propose and consummate a competing business combination. Thus, directors are not able to take advantage of the three-year statutory moratorium to enter into transactions with themselves or with a third party to the exclusion of others and thereby avoid a fair auction process.

5. A person may conduct a proxy fight, take over the board of directors, and have the new board approve his stock acquisition or business combination in advance, thereby escaping the prohibitions of the statute.

6. Stockholders may amend the bylaws to exempt the company from the operation of Section 203. Such an amendment is not effective for 12 months following its adoption, and is inapplicable to any person who was an interested stockholder prior to adoption of the amendment.

7. An interested stockholder may acquire the company without approval of its board of directors, dispose

of the assets of the corporation, to nonaffiliated persons and share the proceeds equally with all remaining stockholders.

<u>Subsection (a) - The Operative Provision</u>

Subsection (a) of Section 203 contains the prohibition against business combinations. It applies to a proposed acquiror who desires to become an interested stockholder (defined as a person owning 15% or more of the corporation's voting stock and who wishes to consummate a business combination within three years. The business combination will be permitted only if, (1) before the person becomes an interested stockholder, the board of directors of the target company has approved that person's becoming an interested stockholder or has approved the business combination, (2) the interested stockholder acquires 85% of the outstanding voting stock in the same transaction in which he becomes an interested stockholder (excluding from that determination any stock held by directors who are also officers and by certain employee stock plans), or (3) after becoming an interested stockholder obtains the approval of 2/3 of the disinterested stockholders for the proposed business combination.

It should be noted that nothing in Section 203 precludes a proxy contest, pursuant to which an acquiror may attempt to persuade stockholders that they would benefit by a new board of directors who would approve the business

combinations in advance. Section 203 does not affect a proposed acquiror's right to buy stock, whether by tender offer, in the open market, or by private purchase. Nor does Section 203 prevent a controlling stockholder from electing his own board.

Subsection (b) - Statutory Exclusions

Subsection (b) of Section 203 contains certain exclusions such that Section 203 does not apply under the following circumstances:

1. The corporation elects in its original certificate of incorporation not to be governed by Section 203.

2. The board of directors elects to opt out prior to May 3, 1988 by way of an amendment to the bylaws.

3. Stockholders elect to opt out by an amendment to the certificate of incorporation or bylaws, provided that the amendment does not become effective for 12 months and does not apply to a business combination with a person who is an interested stockholder at that time of adoption of the amendment.

4. Section 203 applies only to substantial public companies or non-public companies that expressly opt in by charter amendment.

5. Persons who become interested stockholders inadvertently are provided with means to avoid interested stockholder status.

6. The prohibition imposed is lifted when certain competing transactions are proposed by the corporation.

General Effect of Section 203

Section 203, by prohibiting business combinations for three years, is intended to prevent the acquiror from financing its acquisition with the target's assets. Further, although the statute provides several "outs", they are relatively uncertain at the commencement of a tender offer, and that uncertainty is likely to deter highly leveraged offers. This provides incentive to the acquiror to attempt to structure the acquisition in a fashion that will avoid the three-year moratorium.

For the acquiror to do so, however, he must either obtain the approval of the target's board of directors or secure the approval of a large percentage of stockholders, evidenced by their willingness to tender their shares.

It is appropriate that the acquiror negotiate with the target's board of directors. The board has a duty to represent its stockholders in the context of an acquisition attempt. Stockholders themselves cannot act as a cohesive group. The board of directors of necessity must act as the stockholders' elected representatives.

Given the fiduciary duties of the board of directors, and their roll in corporate management, it is appropriate for them to negotiate on behalf of the stockholders. Delaware law imposes on the directors an

obligation to act reasonably and in good faith in the face of a tender offer. Their discretion is not unfettered, and they must conduct a careful investigation and respond in a balanced and reasonable way to a proposed acquisition.

It is intended that Section 203 promote negotiation between an acquiror and the corporations board of directors. If that negotiation ultimately fails, then the acquiror is free to pursue the stockholders. If he is successful in attracting 85% of the voting stock (excluding stock held by director-officers and certain employee stock plans), then he may proceed free of the restrictions imposed by Section 203. Alternatively, even if he fails to obtain 85%, if after gaining control he can obtain the approval of 2/3 of the stock not owned by him, he may consummate a business combination.

Section 203 is perceived to have a variety of advantages. First, it balances the interests of the offeror and the stockholders. The offeror has a variety of meaningful ways to avoid the business combination moratorium. Stockholders, however, can insist upon a sufficiently fair price to convince 85% to tender. Bargaining strength is provided through the board of directors.

The statute also tends to curb the front-end loaded, highly coercive tender offers. The statute does not increase the exposure of directors to personal liability, as other models might, it does not affect voting rights, and it

imposes less severe restrictions on takeovers than other statutes, such as the New York model.